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SOCIAL AND INSTITUTIONAL PROFILE

PART I

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PRIVATE SECTOR

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for the

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These Part I activities have involved many of the staff members of AID/Ecuador, including the Director, Orlando Llenza.

Particular mention is made of Paul Fritz, Patricio Maldonado, Bob Jordan, and Randy Roeser, all of whom were involved in supervising and assisting at some point during the activities.

Pamela de Cárdenas has been the hardworking and effective research assistant as well as an efficient word processor.

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## I. Background

### A. SIP Program

An interest in providing AID missions with greater access to broad social science skills for program development purposes led in the late 1970's and early 1980's to the development by AID/Washington of the "social and institutional profile" (SIP) program.<sup>1/</sup> The intention of the SIP program has been to provide missions with social science skills over and above those which are applied to the analysis of individual projects. To quote from an internal communication:

"...this is a pilot program, and the purpose is to provide missions with very open ended access to social science skills for them to apply as they see fit in support of program development. ...the intent is to provide missions with the opportunity to use social science skills in non-project ways. ...the promise inherent in it..., is that of improving the utility of social science in the Agency. <sup>2/</sup>

For the missions the attraction of the SIP program has been the possibility of using it to help develop new strategies and programs.

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1/ Actual initiation occurred in FY 1982. By the end of FY 1983, some dozen SIP's had been prepared.

2/ From a 30 November 1982 letter describing the SIP from the officer in AID's office of Policy and Program Coordination who dealt with the SIP program addressed to the AID Mission to Zimbabwe (and subsequently sent to AID/Ecuador) which was seeking guidance as to the nature of a SIP.

Each mission has tailored the activity to meet particular programming needs.... The general rule has been that missions use the SIP to explore topics and geographical areas that are not well understood, but which seem to offer sound prospects for mission involvement. The SIP can be long or short term, focused on one sector or several (or on intersectoral linkages).... All these matters are decided by the mission, in accord with their assessment of what needs to be done and how best to do it.<sup>1/</sup>

After briefly in late 1981, considering using the SIP program to explore a broad (but not necessarily program related) range of poverty issues, <sup>2/</sup> AID/Ecuador's interest in the SIP program shifted to using it to develop program initiatives involving the private sector and those which would be supportive of decentralized development strategies. By early 1982, the SIP program in the case of Ecuador was being seen as a vehicle for examining relationships between the government and private business associations, an interest which gradually evolved into a focus on the development potential and needs of the private sector. By early 1983, a geographic focus on secondary cities and small towns, and particularly on the revenue generation capacity of municipal authorities, had been added.

B. AID/Ecuador's SIP

1) Program Relationship- Part I and Part II

The Ecuador SIP has been conceptualized as an on-going or rolling series of investigations of the constraints and institutions of selected sectors. The emphasis has been on the

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1/ Ibid.

2/ In this brief period, it was considered that several SIP documents had already been done by the Mission including several on poverty and on women.

process, that is on a reiterative relationship between the integrated consideration of the economic, social and institutional aspects of particular sectors and the development of program initiatives rather than on the production of a single document or set of documents representing a SIP. SIP activities in Ecuador have made social science skills available and useful to the orientation and design of Mission strategy, programs and projects.

This document is entitled Part I. Part II activities dealt with local government <sup>1/</sup> and were linked to the Mission's programmatic interest in a decentralized development strategy emphasizing the economic potential of Ecuador's secondary cities. The activities or process which were Part II laid out options and recommendations and led to the evolution of the Mission's revenue generation project. <sup>2/</sup>

Part I activities have dealt with the private sector and are intended to contribute to a better understanding of the roles and development potential of Ecuador's private sector.

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1/ See report, AID/Ecuador, June, 1983. Part II activities examined the financial situation, the institutional and legal relationship and specific needs and demands of local governments in Ecuador. Three individual consultants (David Greeytak, Mauricio Silva and Pirie Gall) and a Research Triangle Institute team headed by James Hicks were involved although only Gall's work was covered under the SIP funding program.

2/ Through the Revenue Generation for Development project, internal revenue experts are working with the Ministry of Finance to develop insights into overall tax policy and to help to strengthen internal tax collection and move toward a more progressive tax incidence. In the municipal component of the Revenue Generation project, USAID is working with national-level organizations to bring about a reorientation in their functions which will promote decentralization and increased municipal revenue generation.

They have been a key part of the Mission's larger effort to formulate a strategy for strengthening and channeling assistance through Ecuador's private sector and have led to recommendations for program and policy emphases and to specific project activities within selected productive sub-sectors. The focus on the private sector had its initial start in the work of Alfonso Arcos who, on a part-time basis from March-November 1983, gathered information on more than 150 private organizations in the agricultural and agro-industrial sectors.<sup>1/</sup>

A somewhat similar exercise (although not SIP funded) covering private voluntary organizations in Ecuador had been carried out for the Mission during 1982.<sup>2/</sup>

## 2) Author's Involvement

The author's involvement with the SIP began in late May, 1983 and continued until March, 1984 through five short-term assignments with the Mission. Three of these were funded under the SIP program. My focus has been Part I, that is on activities which would assist the Mission in initiating a private sector development program. When I began, the work of Arcos referred to above was underway and a broad overview of the private enterprise sector had been prepared under a Mission contract with ANDE, the national association of business people.<sup>3/</sup> My contribution at the outset was to assist in the refining of the sectors which the Part I SIP work would address and in identifying concepts which could be employed in discussing the dynamics of institutions as vehicles for

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1/ See Alfonso Arcos, "The Agricultural and Agro-Industrial System in Ecuador," 1983.

2/ See, La Unión de la Comunidad del Este de Los Angeles (TELACU), "Informe sobre el Tercer Sector: el Movimiento de Organizaciones Privadas de Desarrollo para el Ecuador," and, "Directorio de Organizaciones Privadas de Desarrollo en el Ecuador, 1982.

3/ See, ANDE, Ecuador: Situación y Perspectivas del Sector Privado, Quito, 1983.

development.<sup>1/</sup> Subsequently I worked on a review of the non-traditional export sector and its institutions, on the development of a broad private sector strategy for the Mission, and on the preparation of the economic, social and political analyses of the 1986 CDSS.

### 3) Program Outputs of Part I

The programming outputs of the Part I work on the SIP are, most notably, the private sector strategy and program elements developed by the Mission and presented in a concise form in the 1986 Country Development Strategy Statement. They also include, as part of a wider Mission effort, the orientation of the Mission's broad program to emphasize assistance to Ecuador's productive sectors in support of a structural adjustment of the economy over the medium term (see, pp. to for the economic background). These Part I SIP activities, in terms of project outputs, have provided a strategic and programmatic framework for the development of Mission projects in export promotion (funded in FY 83), agribusiness development and small enterprise credit (likely to be funded in FY 84).

### 4) Sources

This document is a pull-together of many efforts and thus sources are mostly secondary ones. Some of the sections draw upon work originally done by the author and for further elaboration and for additional citations the relevant reports should be consulted. These sections are: all those of Section

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<sup>1/</sup> This is the basis of the methodology discussion which follows (p. 8-15). The concepts were applied in an examination of an agribusiness sub-sector (abacá, see below, pp. ) as a demonstration, and subsequently in a full examination of the non-traditional export sector (pp. ).

II 1/, and , of Section III, those sections dealing with non-traditional exports 2/ and the abacá case study of the agribusiness sector discussion. 3/ The other sections of the agribusiness discussion rely upon secondary sources which have been cited and the work of Alfonso Arcos 4/ and Douglas Chiriboga. 5/

The discussion of the small enterprise sector is based upon interview and secondary materials gathered by Pamela Cárdenas and reviewed by the author. 6/ Economic and other statistical data have been drawn mainly from the national

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1/ See, James Finucane reports of 30 June 1983, 20 September 1983, 17 December 1983 and the 25 January 1984, draft of the 1986 CDSS. The exceptions (e.g., the comments on the agriculture and energy sector) are noted in the document.

2/ See, report of 20 September, 1983.

3/ See, report of 30 June, 1983.

4/ See, Arcos, op.cit..

5/ Chiriboga produced a draft PID for an Agribusiness development project from which some of the background analysis and most of the constraints presentation is taken, see the draft PID dated 1/20/84.

6/ The following are the main documents reviewed and from which the small enterprise discussion draws: Luis Luna Osorio, Investigación sobre la situación de la Pequeña Industria en los Países Miembros del Acuerdo de Cartagena: Situación de la Pequeña Industria en el Ecuador, Quito: Escuela Empresarial Andina del Convenio "Andrés Bello", August, 1981; Nicolas Molenzar, "Small Scale Industries Program (FOPINAR): Technical Assistance Component, "Delft: Research Institute for Management Science," 1981; CONADE-ILDIS, Las Políticas de Fomento a la Artesanía en Ecuador, Quito, 1983; Artesanías y Políticas Estatales, Mayo, 1983; CENAPIA, "Estudio sobre la Pequeña Industria en el Ecuador," Quito, 1981; Fundación Ecuatoriana de Desarrollo y Acción Internacional/AITEC, "Programa de Desarrollo de la Micro-empresa," a proposal presented to AID/Ecuador, 1984; FENAPI, "Informe del Presidente," Quito, 1983; World Bank, Development Problems and Prospects of Ecuador, Vol. II., 1979; and IBERD, "Second Small Scale Enterprise Credit Project, Ecuador, Staff Appraisal Report," 1982.

accounts recently published by the Central Bank<sup>1/</sup>, from a compendium of statistical data supplied by CENDES, the national industrial development center <sup>2/</sup> and from a statistical appendix to an earlier World Bank report.<sup>3/</sup>

### C. Methodology

#### 1) Background

Although the SIP part I activities have ranged quite widely in scope, a main interest at the outset was in considering the development potential and role of private sector organizations, and in developing an approach or a methodology which could be used to do this on a continuing basis. The methodology which was employed in several parts of these Part I activities has been one which emphasizes the development potential of organizations as opposed to a simple description of current roles and activities. Early SIP Part I activities and related efforts in Ecuador (e.g., the TELACU study) concentrated on the collection of data of a somewhat static nature yielding products similar to directories with basic information. This tendency in turn gave rise to two requirements. First, there was a need to augment the data collection with material which would indicate the dynamics of the organizations, specifically their capacities to operate as development organizations and the nature of their interactions within the larger environment. Secondly, there was a need to define these capacities and the larger environments or systems in terms relevant to AID/Ecuador's interests in export development, agro-industries and small scale enterprise. <sup>4/</sup>

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1/ Central Bank, Cuentas Nacionales del Ecuador, 1983.

2/ CENDES, Datos Básicos para Inversiones Industriales en el Ecuador, Quito, 1982.

3/ World Bank, Ecuador: Problemas y Perspectivas de Desarrollo, Vol. II: Apéndice Estadístico, 1979.

4/ The interest in these sectors is not exclusive, of course. The Mission has activities in many other sectors. The interest in small scale enterprise was not clear at the outset. The third area of interest shifted from "agricultural marketing," to "social sector," (specifically, private efforts in health, housing and family planning) to small business.

These needs for 'dynamic' and 'centralized' information had several implications. The first, the need for a non-static focus of the capacities of institutions, reinforced the view of the SIP as a "rolling" process which would be a practical tool for the Mission in its programming and policy related activities. Thus survey and analysis efforts would be focused on various sets of institutions in turn, with the sequence being purposeful. The "purposes" would be determined by the priority programmatic needs of the Mission, but not dogmatically so. This supposes a reiterative relationship between documents such as SIPs and CDSSs with each serving, over time, to inform and influence the direction of the other, as indeed occurred with the 1986 CDSS.

Having defined purposes was necessary to make the entire SIP exercise rational and helpful. In plain language, it would be nearly impossible to talk of roles and potential of private sector organizations in isolation from some more concrete idea of roles in what and potential for what. With a development assistance programming need to be able to make judgements, it was essential to examine institutions within a framework which was relevant to broader development and program priorities. Agricultural sector institutions, for example, could be looked at in relation to the production and commercialization systems of which they are a part.

The other major implication was the need to select a methodology to use in conceptualizing and articulating in the SIP the capacities of private sector institutions (that is, organizations) to perform their roles and to realize their potential. Over the twenty and more years that professional work has addressed the need for and the ways to go about institution building and strengthening, a certain amount of now conventional wisdom has been achieved. Much of this experience was reviewed by the World Bank in a 1980 staff document, by AID in a 1982 staff document and in the March 1983, AID policy paper on institutional development (which see for citations). The conceptual framework for analyzing the capacities of organizations which is outlined in the following pages draws from this experience.

## 2) The Institution's Context

A fairly simple "systems" approach to analyzing the functioning of organizations is a viable way of marshalling, thinking about and presenting data. It is not the only way, and carried too far it raises obvious questions about the

static and empiricist biases which can turn its advantages into disadvantages. What has been intended for the Ecuador Part I SIP activities has been more of a systematic approach to the subject rather than a full-blown systems analysis exercise.

To give the reader a fuller idea of what is meant here by this "systems" approach, an example, developed as a case study in a SIP working document of the abacá production systems in Ecuador is summarized here. The various activities (functions) which at the outset it was predicted would need to be performed within the abacá production system are: land supply (for production), basic raw material supply (for processing), technical information supply, purchased input supply, equipment supply, credit (for various purposes and terms), transportation, storage labor, management, research and product development, promotion, market information, physical infrastructure (roads, power, etc.), product markets, investment, policy.

The presumption is that by first listing in as comprehensive a fashion as possible all the supposed components (functions) of the system and then by systematically looking at each one of them and at the organizations performing them (and of course by revising the outline of components as new information becomes available) that one will be in a strong position to make statements about organizational roles and potential. In the rural development field the 1981 publication of Jon Morris on Managing Induced Rural Development (with AID financing) provides a state-of-the-art review of institution building as well as a discussion of a systems perspective. In the case of Ecuador's SIP of the private sector, the premise has been that a similar approach needs to be adopted for the mission's major program areas.

At one level this approach is easy to apply, and it makes the rest of the SIP activities easier as well. It can operate as an amendable and expandable checklist to ensure that one is being complete, and it assists to pinpoint rapidly gaps, constraints, strengths and opportunities.

At another level it is quite an arbitrary and, hence, difficult method and I do not wish not to acknowledge this weakness. That is, one must decide what the system is, what its boundaries are, and what is worthy of study within it. Take the case of abacá. It was conceptualized as a production system and the major components were identified in relation to their presumed or expected contribution to the production and exportation of abacá. One could just as legitimately (given, say, a priority focus on the degree of equity being produced by the system) have conceptualized it as a system for

the control and distribution of valued goods such as wealth, status and power. The components identified in that case would have been quite distinct.

This context approach has not been employed fully as yet in the SIP activities. It can be seen in the treatment on non-traditional exports, it has been used but less extensively in the presentation of the small enterprise sector, but it has been used only in a minor way in dealing with agro-industry.

### 3) Organizational Capacities for Development

The SIP, in its discussion of private sector institutions in the non-traditional export sector and in the agrobusiness case study of abacá, addresses organizational capacities to i) mobilize resources, ii) manage resources, iii) create development opportunities, iv) interact in an effective fashion with other organizations, v) learn and adapt over time. Private organizations which perform these functions well are strong organizations that will play a role of influence and have a development orientation in whatever private sector system one is examining.

The following discussion briefly comments on each of these five capacity areas. Taken as a whole, they can provide a useful development perspective on an institution. They also can serve as an organizing framework for presenting material on an organization in support of judgements made as to roles and potential. These judgements are prerequisites to any conclusions as to major weaknesses and needs.

1) To survive organizations mobilize resources. Often the better organizations mobilize net additional resources for the sector or activity in which they are involved rather than simply winning a larger share of the sector's resources. Examples would range from private companies expanding their markets and product lines and capital base to environmental groups supporting themselves through sales of publications and memberships. The resources can be economic information, financial and human. Good performance records would indicate expanding resource bases (e.g. in budget size, memberships lists), diversification of basic support sources (e.g. new markets, new supporters, new clients), and increasing stability of resource flows. Resource mobilization would include those additional resources mobilized to the system by the performance of the organization.

ii) Organizations by definition manage resources to achieve purposes. Internal systems (planning, budgeting, personnel, accounting, auditing, others), whether formalized or not, are necessary and the appropriateness and effectiveness of these systems are important capacity measures. Good performance records would indicate coherence between inputs and outputs, problems surmounted, improvements made and, in financial and other terms, traceable accountability. Personnel are, of course, key, and systems which deal with hiring, training, reviewing and developing staff are important to judge. The quality, morale and performance of the staff are in this sense bottom line indicators and while not wholly dependent on internal systems, they will be affected by them.

iii) In a development context, organizations which contribute to raising production, productivity and incomes are the sine qua non. The innumerable situation specific ways in which such contributions are made can be placed in four broad categories: contributions to human resource development (training, increasing breadth of access to resources); contributions to technological change and improvement; contributions to the raising of savings and investment levels; and contributions to the expansion and diversification of the markets for goods and services.

iv) All organizations operate within a wider system context or environment the boundaries of which are subject to analytical definition. How one will wish to conceptualize interactions and boundaries will depend in large measure on the purpose. However, it is clear, and sadly demonstrated in the difficulties of many project interventions, that the relative success or failure of organizations is associated with the nature of their relationships with other organizations and groups and to the strength and completeness of the system itself. Downward links with clients, members, subscribers, "the people" and the public, horizontal links with complementary and competing organizations, and upward links with policy levels (e.g. to defend and promote interests) are aspects which need to be considered in appraising the effectiveness with which an organization operates in its environment. Notwithstanding the tautology that all parts of a system are integral, some organizations are "heavier", play more significant roles, and have greater potential. These need to be identified.

v) Much attention has been paid over recent years to the insights to be gained from taking a "learning" approach to

organizations and to project interventions. Although this may appear a bit soft when contrasted with a results-oriented perspective, the necessity for a learning and adaptation approach, and, on the other hand, the sheer limits of a "blueprint" approach, are now widely appreciated, though no less trying and problematic in their application. Two general points are of interest: first, learning curves for organizations normally run from the development of available product or services ("model" in the development literature), to the reduction of unit costs and the achievement of operating efficiencies, to growth and diversification ("replication"); second, learning requires a commitment which will be observable in systems, practices, incentives, structures and continuous in adaptations which will be indicated in a performance record of crises surmounted, changes in activities and increasing coherence internally and with the environment.

## II. Development Context

### A. Poverty<sup>1/</sup>

In spite of remarkable social progress during the last 20 years, Ecuador still displays many of the characteristics of a severely underdeveloped country. Life expectancy at birth increased from 51 years in 1960 to 61 years in 1980; infant mortality declined from 140/1000 in 1960 to 71/1000 in 1982; and child mortality (ages one to four) declined from 28/1000 in 1960 to 8/1000 in 1980. The adult literacy rate increased from 68 percent in 1960 to 81 percent in 1982, and enrollees in primary education as a percentage of the 6-11 age group increased from 83 percent in 1960 to 107 percent in 1976.<sup>1/</sup> The ratio exceeds 100 percent because over-age students are enrolled in primary school.

Nevertheless, basic poverty indicators are high and social services are inadequate. Only 32 percent of the total population in 1977 had access to excreta disposal systems. The infant mortality rate is still one of the highest among countries of similar levels of development, and nearly 50 percent of all mortality occurs in children under five, even though this group constitutes only 16 percent of the total population. Around 40 percent of children under five years of age are malnourished. Diarrheal diseases and respiratory infections -- both preventable, controllable problems -- are the two leading causes of death. The housing deficit reached over 900,000 units in 1983.

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<sup>1/</sup> The poverty data in this section, much of which was used in the 1986 CDSS, comes from several AID financed studies (Carlos Luzuriaga, Poverty in Ecuador, Quito, 1979; Luzuriaga and Clarence Zuveckas, "Distribución del Ingreso y Pobreza en las Areas Rurales del Ecuador," Quito, 1980), from multilateral donor reports (mostly the IBRD), from data supplied by Mission technical staff during the preparation of CDSS, and from the author's analysis of official Ecuador data.

Rural poverty is especially marked. Of a total of 570,000 farm families, approximately 380,000 have farm holdings of less than 5 hectares. In the Sierra, which has 350,000 of the farm families, 275,000 are on farms of less than 5 hectares. This ownership pattern contributes to low incomes. According to IDB estimates, currently about 2.6 million rural inhabitants live in poverty. These are basically small farmers, smallholders and agricultural laborers, and they represent about 60 percent of the rural population. The per capita income for this group in 1983 is estimated at US\$ 295, which is 25 percent of the average income for the rest of Ecuador's population, calculated at approximately US\$ 1,160.00. In addition to land scarcity and low incomes, these families suffer disproportionately high rates of infant mortality, morbidity and illiteracy. In some areas infant mortality runs as high as 150 per 1,000 in contrast with a national average of 64.4 per thousand, the adult literacy rate is around 40 percent compared to 82 percent nationally and about 70 percent of all rural children drop out of school by the fourth grade. While the rural sector has approximately 50 percent of the population, housing in rural areas with facilities for excreta disposal, electric light and piped water amount to 12.5 percent, 13 percent and 11.5 percent of all housing.

Geographically, though rural poverty in Ecuador occurs throughout the country's 20 provinces and 115 counties, it is concentrated in the Sierra. According to a Mission analysis (based on eight indicators including income, incidence of minifundio, mortality, education and other basic services), the poorest 13 counties in the country are located in the Sierra, eight of them in the southern half. Of the 35 poorest counties, 25 are located in the Sierra and 10 in the Costa. There is also severe poverty in the Oriente; among the poorest people in Ecuador are 80,000 primitive Indians who are prime candidates for cultural or even physical extinction as colonization progresses in that part of the country.

To deal with these problems of rural poverty and small and/or landless farmers, government policy has pursued two primary approaches, agrarian reform and integrated rural development. The agrarian reform program was initiated in the 1960's to break up large estates and provide the land to workers on the estates. It focused on landownership as one of the essential conditions for alleviating the plight of the rural poor. According to official reports, while 119,000 families were beneficiaries of land reform between 1964 and

1982, these families generally remained as poor as before. The smallness of the parcels given to recipients accentuated the minifundio problem and this was compounded by the lack of availability or of access to needed technical assistance and credit for the purchase and adoption of modern technologies. These problems were accentuated by inefficiencies in the marketing system and negative government price policy that reduced incentives to these farmers to use new technology if it were available. In response to these shortcomings, the Ecuador government in the late 1970's adopted an "integrated rural development" approach to provide technical assistance, credit and marketing services to the rural poor. As of the end of 1983, however, the integrated rural development efforts were doing poorly for institutional reasons (weak coordination and implementation capacities) as well as because of official price policies. Wheat price policy, until 1983, directly discouraged small landholder production of wheat through the wheat consumption subsidy negatively affected the demand for and price of potatoes, another product produced by small landholders.

The critical situation of rural poverty in Ecuador does not, unfortunately, imply the absence of urban poverty. The slums of Guayaquil are visible evidence of one of the worst conditions of urban misery in Latin America. To illustrate, an Economic Commission for Latin America study on the largest barrio suburbano of Guayaquil, one of Latin America's most depressing slums, found: (1) most of the workers in a state of permanent underemployment; (2) an almost total lack of economic and social mobility; (3) 50 percent of the households headed by women, who have even less chance than men for decent paying, productive work; (4) 47.6 percent of the labor force having started working between the ages of five and fourteen and thus locked into jobs paying from \$14 to \$40 per month; (5) 70 percent of the population leaving school before the secondary level; (6) housing which does not meet even minimal standards, mostly consisting of crowded one-room bamboo or wood units on stilts, with no water connections or sanitary facilities; and, (7) the neighborhood filled with open sewers, trash dumps, and other breeding grounds for transmissible diseases. The urban poor, although they tend to have higher nominal incomes, usually derived from informal sector employment, frequently face higher costs for food and other necessities than do the poor in rural areas.

The government's approaches to urban poverty, aside from basic service provision, and widespread community development activities, have dealt principally with the small enterprise and artisan sector. The approaches to this sector have tended to emphasize guild like protection and general incentives to raise production and productivity. The results of these efforts, many of which have been of a pilot or initial nature, have been minor when compared with the scale of urban poverty, but they are encouraging in that they indicate viable options to be further developed in the future. For instance, the IBRD financed and CFN executed first small scale enterprise project (FOPINAR) which made term credit available to small scale enterprises through the private banking sector was particularly successful in the Manta/Portoviejo area pointing up the possibility of mounting additional efforts at the secondary and lower level cities in the small scale enterprise sector. It has now been followed-up by a second project.

Ecuador's income distribution pattern is very unbalanced. An IBRD study (1980) indicated that the lowest 40 percent of the population receives only 6.5 percent of income. The smallest 78 percent of the landholders hold only 12 percent of the land in farms, while the largest two percent control 48 percent. The 1980 study by Luzuriaga and Zuveckas on the poverty situation in Ecuador shows that around 60 percent of Ecuadoreans live under conditions of poverty. It concludes that "the overall distribution of income remains very unequal", and has worsened as a result of Ecuador's deteriorating economic situation. Moreover, the government estimates that around 50 percent of Ecuador's workers are underemployed and do not earn enough to satisfy their basic needs.

The trends in income distribution have not been steady although there are no indications that the relative position of the poor has been improving. An IBRD study indicated that the distribution of income had improved somewhat between 1968 and 1975, in contrast to the deterioration which occurred during the 1960's. It appears that this improvement reflects an increasing share of income by the middle class at the expense of both the relative shares of the highest and lowest income groups. Whether this trend has continued into the 1970s is difficult to say. The government's import substitution strategy in the industrial sector would appear to have worked to worsen the position of the poor. Capital-intensive

technologies have been encouraged at the expense of investments which could have taken advantage of Ecuador's factor proportions and created more jobs. These policies have tended to increase the concentration of assets, productive resources, and income, and have benefitted mostly the upper and middle income groups. Agricultural sector policies, while intended to be rural welfare oriented, would appear similarly to have worked to the disadvantage of the poor. Price controls on basic food items have discouraged domestic production and benefitted urban dwellers at all income levels, at the expense of the rural poor. In education, where public spending has increased rapidly since 1969, the budget has been heavily skewed in favor of the universities. The central government's reliance on indirect taxes for 55 percent of its tax income is regressive.

A number of recent GOE policies will affect the distribution of income and the absolute incomes of the poor. For example, increases in the minimum wage have had the effect of increasing the welfare of lower middle and middle income groups at the expense of the highest income groups. Since the Central Bank estimates that only 20 percent of the rural labor force and 42.5 percent of the urban labor force are regular wage and salary workers and thus beneficiaries of minimum wage legislation, the majority will have their employment opportunities reduced by it. Similarly, public subsidies on gasoline and wheat (since poor farmers are producers of wheat substitutes: rice, beans, potatoes, and corn) have had the effect of worsening the relative position of the poorest income groups. Thus, the recent elimination of the wheat subsidy and reduction of the gasoline subsidy should have a favorable impact.

Over the next several years, official approaches to poverty will be constrained by Ecuador's critical economic and financial position. Government resources which were plentiful during the oil boom will be tightly restricted. In the short term, the impact of the 1983 natural disasters on the poor will likely be mixed. Many rural producers on the coast, of course, had their crops destroyed or were unable to market them due to infrastructure damage. In addition, many poor people (landless rural workers and the urban poor) have seen their real incomes reduced drastically because wage increases have been far less than the increase in food prices, which have a very large weight in their consumption patterns. On the other hand, rural smallholders outside the areas immediately affected by the floods probably have experienced a considerable increase in their real income due to rising prices.

**B. Minorities and women**

Over 60 percent of the rural inhabitants of the Sierra are Indians in various degrees on integration with Spanish-speaking society. Indians are also found to some extent in Sierra urban areas and on the Coast as landless laborers. There are also small indigenous communities on the Coast and in the Oriente. In addition, there are an estimated 300,000 blacks, concentrated in Esmeraldas Province on the Coast and in one small pocket of the northern Sierra (two blacks were among the 205 residents registered when Quito was founded in 1534). Studies have shown that the traditional values of Ecuador's Spanish-oriented culture imposes serious barriers to the socio-economic mobility of these groups, making it especially difficult for them to escape from poverty. <sup>1/</sup> Current and economic relationships can be tracked back to the earlier patrón-peón relationship. While this legally established pattern under which the campesinos were virtually the property of the hacienda owners has been terminated by law, it has been replaced by economic relationships that restrict the spectrum of educational and socio-economic opportunities. For instance, the dependency situation of the small Indian farmers in the Sierra, under which they must seek at least part-time wage income to supplement that from their uneconomic parcels, bears close resemblance to the patrón-peón relationship. Sheer racial and social prejudices against Indians and blacks also makes mobility for these groups disproportionately difficult.

Further obstacles are faced by women, rural and urban. They are particularly acute for the large number of female heads of household in urban slums and squatter settlements who are seeking productive employment. Typically, the urban poor person is a woman head of household, with a primary school

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<sup>1/</sup> See, for instance Osvaldo Díaz, El Negro y El Indio en la Sociedad Ecuatoriana, Quito: Ediciones Tercer Mundo, 1978; Ronald Lee Stutzman, "Black Highlanders: Racism and Ethnic Stratification in the Ecuadorian Sierra," unpublished Ph.D. thesis, Washington University, 1974.

education or less, who entered the labor force between the ages of five and fourteen. In rural areas, men are considered the authorities in all matters pertaining to the home and community. But in reality, women are often the key decision-makers for the household's economic activities, including planting, harvesting and marketing. Social and cultural factors have prevented rural women from being adequately trained to carry out this de facto role effectively.

A USAID sponsored study on the role of women in Ecuador<sup>1/</sup> concludes that women are far from reaching their full potential in Ecuador's development. They are largely bound to their traditional roles as wives and mothers, and the process of improving and recognizing their participation in society is very slow, particularly for the lower income groups. Women are also subject to various forms of open and disguised discrimination. Discrimination affects mostly female heads of households that have to overcome imbedded traditional obstacles in competing with men for employment and income earning opportunities. Women's labor is often not regarded officially as "work", thus preventing many working women from having access to benefits such as those accorded by the country's social security system. Women's access to educational opportunities, with some exceptions, is also limited to certain traditional fields, and many of those who succeed in fields traditionally dominated by men usually face serious difficulties in advancing their career in those fields.

Neither the government nor private groups have yet set up adequate institutional mechanisms to promote the role of women in the economy and society. The government's Women's Office, created in 1980 mostly for political purposes, is moribund. It lacks the resources and the political support needed to promote significant change. A similar conclusion can be drawn with respect to the position of blacks with the exception that a separate office has not been created. With regard to the participation of Indians in Ecuador's development, it is an issue of such pervasiveness that in many aspects it corresponds to the issue of Ecuador poverty as such, and thus progress will only be achieved in relationship to overall success in achieving a pattern of economic growth which also serves to reduce poverty.

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1/ Carlos Luzuriaga, "Situación de la Mujer en el Ecuador," Quito, 1980.

C. Political Context

After seven years of military rule, Ecuador elected an essentially populist government in 1979. This government, which will go out of office on August 10, 1984, in its initial years in office pursued economic and social policies which were expansionist and welfare oriented and which contributed to the significant growth in the size and participation in the economy of the public sector. This growth occurred not so much because of any strong ideological commitment to state control of the economy, but rather because of a belief in the need for the state to promote development, encourage employment and protect consumers, a combination partly Prebisch, partly Keynes and partly populist.

In the last years of its term (1982 through the beginning of 1984), the current government's policy orientation, in the context of the external sector crisis, steadily shifted to a more austere, less interventionist role for the public sector and to beginning to create the framework for a more market-oriented, efficient economy. Its negotiation and successful implementation of the IMF program and its rescheduling of the external debt have essentially stabilized the situation. The stern measures (e.g. reduced public sector expenditures and import restrictions) taken to achieve this stabilization contributed to economic contraction and to a move away from welfare and towards an emphasis on production as an approach to development in Ecuador.

With the success of stabilization, the focus has shifted to structural adjustment. It can be expected that in the short run given the extent to which people have become accustomed to subsidies and protection (and in macro-terms consuming at levels higher than production), that the adjustment, if implemented, will cause major dislocations and hardships which will be felt at the level of families and individuals, and which will have differential repercussions in the nation's regions and sectors.

Given this recent economic background, the major political question is whether the government which will take office in 1984 will be able to carry out the necessary structural adjustment. Six factors will be mentioned as relevant to any speculations as to the answer to this question.

First, a major political trend in Ecuador has been for the rate of growth in the number of people who are aware and who in some way participate in the political system (and thus to whom any government must respond in some form) to greatly exceed the rate of growth in population. For instance, in 1984, 45 out of every 100 Ecuadoreans were eligible voters; in the last election, in 1982, it was 29 out of every 100; in the election of 1952, when Velasco Ibarra was elected for the third time, to give a long term perspective, it was only 15 out of every 100. In other words, while population over the last 32 years has increased 2.5 times, the number of eligible voters has increased by a factor of 7.5. Roads now link areas of the country formerly isolated from the national politics; education and transistor radios are now spread throughout the country. The urban population, often the group most politically mobilizable, is now more than 4.1 million people; in 1952 it was less than one million. That many Ecuadoreans are not politically organized (less than 25 percent of the voters are members of a political party), may mean that the situation is more volatile and less predictable than if they were.

Secondly, a trend which has been slowly developing over the last fifteen years has been for political parties to act increasingly in line with an ideology or set of considered political principles. This change has not yet gone very far. It is, nonetheless, quite distinct from the pre-1960's tendency for parties to maintain an identification in relation to their closeness to or distance from the Catholic Church, and from the continuing populist tradition of the leader whose personal power and other qualities, it is asserted, will result in the nation benefitting from his rule. The Izquierda Democratica, the leading party in the first round of the 1984 elections, is an organized, center-left political party in a European mold, that is it has a mass membership and an ideology and the party is probably more important than the leader (Rodrigo Borja Cevallos). One implication of this change, and of the above mentioned rapid increases in the number of people who participate, will be for policies and programs to be considered much more consistently in terms of who, in a class sense, benefits.

Thirdly, Ecuador has not experienced the guerilla warfare found in many parts of the region including currently in its closest neighbors, Peru and Colombia. Speculation as to how Ecuador has managed to avoid this phenomenon is not uncommon, nor is the concern that it may as yet become a reality. Certainly the widespread poverty and growing participation which often establish the potential for such a phenomenon are present in Ecuador. All the major national political elements are aware of this potential, and one can expect that the new

government will take this into account in deciding the details and pace of any structural adjustment efforts.

Fourthly, political fragmentation in Ecuador has and will continue to affect the ability of any government to act decisively. Political power has usually been held by central governments dependent on coalitions and subject to intense pressures from individuals or special interest groups including urban-oriented labor unions and middle class student groups as well as the elite. The degree of political fragmentation and the low capacity of the central government to elicit a wide range of support makes important policy decisions especially difficult to take.

Fifthly, one must consider the stances of the leaders and two coalitions in the final round of the 1984 election towards Ecuador's development needs and towards the requirements for structural adjustment. On this point, the perspective is not clear. All the major parties in the first round managed to combine statements about the need for more public sector austerity and for an emphasis on raising output and export levels with populist promises for delivering jobs and more services. Private sector leaders, who can be found in the ranks of all the major parties, can be expected to have significant influence in whichever administration is elected, but it is not necessarily clear that they will wholeheartedly support structural adjustment given that many have benefitted from the protectionist framework.

Finally, the military must be considered. Although there is considerable pride in Ecuador at the present time in the success of Ecuador's return to democratic rule in 1979 and the overall success with which the country is now going through its election of a new government, there is always, somewhere, a rumor of a possible military coup de etat. The military has intervened and ruled in recent years (1963-1966 and 1972-1979) continuing what is a tradition of military take-overs in Ecuador. The military governments going back to the 1920's have promoted progressive social legislation and have tried generally to adhere to a "developmentalist" style. They have been consistently opposed by many private sector leaders, particularly of the older hacienda and mercantile classes, whose interests were negatively affected by the social legislation. Military interventions in Ecuador are "legitimate", they are an accepted (that is not to say desired) part of the political culture. Whether the "social costs" inherent in any structural adjustment will lead to sufficient social unrest to cause the military to intervene, is a question which will hover for several years.

The main political question then - whether the new administration will implement the structural adjustment - can be rephrased as whether the new government, in the face of a rapidly growing, political population will give more weight in its policies and actions to its campaign talk of austerity or to its promises of more services. This will not be answered until the new administration, in the second half of 1984, begins itself to grapple with the issue.

#### D. Role of Families

The Ecuador private sector referred to in this section is composed of those individuals and organizations which are directly part of the private enterprise productive system. This is a narrower definition of the private sector than normally used. It gives short shift to community and 'base' organizations, to church organizations, to professional and educational organizations, and to others, all of which are part of the system but not centrally so from a policy making or macro-output prospective. The focus here is limited to those that are, in Ecuador, at times referred to as "sectores de la producción" or as "sectores empresariales".

Family is a central factor in defining the social composition of Ecuador's private sector. Many of the economically strategic private firms are controlled by a fairly small number of families who are interlinked through the main sectors of export, agriculture, finance, construction, commerce and import substitution industry. This phenomenon has been the subject of studies and commentaries ranging from the left with its analyses of the oligarchy and class formation to those in the center and beyond with their studies of the growing middle class.

In all these analyses there is little difference of opinion as to the importance of the family ties. The reading of newspaper reports, and direct questioning of private sector leaders underscores the validity of the viewpoint. This report is not the place to attempt an outline of who these important families are. What is much in question, however, and around which there is much difference of opinion is the orientation of these families toward the concept of the private sector as an entrepreneurial, productive force.

This observer was struck by the contrasts of the summary opinions of the private sector expressed by equally informed and sympathetic informants. On one side, are those that see the sector as being run by unmotivated, unaggressive.

nonentrepreneurial sons and occasionally daughters of the traditional plantation/hacienda class (or clans). They made their money up through the mid-1950's by commodity exporting (bananas, coffee, cacao) and dry goods importing, industrialized during the heyday of import substitution and all that that entailed in terms of protection for non-competitive 'infant' industries, and consolidated themselves in banking and construction, especially during the short years of the petroleum boom. On the other hand, there is the view of the sector as the base of clever and business-minded families which have made vast sums of money in difficult commodity markets and which have shown their capacities to adapt to shifting and often fast-changing external circumstances and to rally the required economic, financial and political resources to move from strength to strength even in the worst of times.

These families, with some exceptions, have been in the main of Spanish-European origin. The main exception has been the Lebanese Christian families that have become important during this century. Others would be several immigrant Jewish and Italian families. The observation as to the ethnic origin of those families is noteworthy in that Ecuador's population is primarily of Indian origin.

The growing size of the educated, professional and business oriented group of Ecuadoreans, a growth which has been dramatic during the past ten years, is a phenomenon partly created by the economic growth of Ecuador and the concomitant recognition of the need to reach out to talented and capable individuals. This phenomenon has weakened the hold of the old families. But "family", and what this portends for the continuing validity or otherwise of the contrasting opinions mentioned above, is a factor that will have to be considered in framing any strategy for 'strengthening' Ecuador's private sector. Not only is it an objective factor, it is a subjective factor on which Ecuadoreans themselves put much stress.

#### E. Location and Regionalism

The Ecuador private sector may be said to have controlled the country at least until the early 1970's. In practice this meant that national political power tended to be concentrated in Guayaquil, the major port, and in the hands of those who were making fortunes in the major plantation export crops of the Costa and in the linked financial and commercial sectors.

Several trends, important now and during the 1970's, served in contradictory ways to affect this concentration of power. Long term developments in education, health, and communications, some the result of "developmentalist" thinking, and others the impact of the changing world, certainly widened the middle class and gave rise to an even larger and perhaps faster growing underclass of people throughout the country with expanded competencies and inflated expectations. The ANDE report on Ecuador's private sector contains a number of statistical tables which indicate how these long term trends were sharply accelerated during the past ten years.

Secondly, the growing importance (though never dominant) of international public sector capital transfers through bilateral and multilateral agencies emphasized the role of Quito, the capital, and of the Sierra, the location of the greatest concentrations of poverty (the latter becoming important towards the end of the 1960's with attempts being made to 'target' development assistance on the poor).

Thirdly, the adherence to an import substitution model of national development created increased opportunities for professionals and others who had some capability to perform in the more management and technology intensive environment of the manufacturing and agro-industrial sectors.

Fourthly, and a trend which may be related to the changed orientation on the part of major sections of the Catholic Church in Ecuador<sup>1/</sup> towards their relations with the poor,

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1/ The Catholic Church in Ecuador, for many years was an institution supportive of the large land owners and the other upper economic classes. Constitutionally, up to the early 1900's, it was a state religion: the Church was responsible for 'civil' registration; one had to be a Catholic to exercise certain rights of citizenship; the Church managed the educational system; other religions were not permitted to establish themselves in Ecuador. In this century, it has lost all these privileges and in addition lost many of its lands and properties, because of changed opinions of Ecuador's political elites. On the other hand, the Church itself began to reorient itself socially during the 1960's to a closer identification with the poor. The impact of the "ideology of liberation" within the Church in Ecuador has, at minimum, been the breaking of the clear link between the Church and the privileged classes of the country. The Church remains, particularly in rural areas, an important institution in the formation of political opinions and in the establishment of the "legitimacy", in the eyes of the people, of policies and political groups.

would be the lessened legitimacy accorded by the wider society to the notion of power being narrowly held by a small group of patrons, be they on the hacienda or in the town. This surfaced several times in interviews directly and more indirectly in discussions of the need for a sense of social responsibility on the part of business leaders.

The most important trend, however, was the shift of power from Guayaquil to Quito (along with the growing power of the public sector) which coincided with the oil boom. The shift had, of course, its precursors: the accumulation of international public sector aid transfers which tended to emphasize the role of Quito as a center; the centrality accorded to the role of the state by the development professionals and the private sector leaders alike, the former thinking of the 'rational' allocation of resources and the latter of incentives and protection, during the import substitution period; the growth of the human resource sectors such as health and education; the gradual shift in population balance from a 60/40 Sierra-Costa split in 1962 to a 50/50 split in 1982. But the impact of oil was dramatic after 1972, and then again after 1974 when the oil price tripled and finally in 1979 when it doubled once more. With oil money flowing in large amounts into the public sector, the public sector's income in 1981 was 250 percent of what it was five years earlier. As one observer put it, "power walked right up the cordillera."

For the private sector one result of the Guayaquil to Quito shift has been much more geographic mobility, with people moving frequently between the two major cities. While undoubtedly serving to strengthen the economic base of the Sierra elites in an absolute sense, it is by no means certain that the major Guayaquil families lost in any absolute sense. The trend has also seen the expansion in the Sierra of the economic base of many of the important Guayaquil families.

A trend which perhaps can be noted in passing is the influence of the international drug traffic. It is said that in at least one of the major provinces the major private sector families are those who have been heavily involved in this trade and who are now converting earnings into legitimate enterprises.

## F. Public/Private Balance

### 1. Growing Economic Role of Public Sector

Private enterprise based production is dominant in the Ecuador economy. 77 percent of gross value added, 60 percent of the wages and salaries paid and 56 percent of the gross fixed capital formation in 1982 were of private sector origin. The government either directly or through several parastatals is the major producer in the sectors of petroleum, communications, electricity, gas and water, and is significant in those of construction and financial services. Public ownership in the major non-petroleum productive sectors of agriculture and industry is of small aggregate value and most commonly has resulted from an intention to prevent a unit's closure, not from any ideological predilection for public ownership. 64 percent of agricultural credit and 88 percent of industrial credit is channeled through the private banking sector.

Trends however, indicate a relatively declining role for the private sector in the Ecuador economy and structurally the sector exhibits critical weaknesses. The government, with the exception perhaps of petroleum, has not moved significantly into the productive sectors implicitly reserved for the private sector, and it has provided incentives and resources in attempting to stimulate private sector growth. Nonetheless, through sustaining relatively higher levels of growth over recent years in "its" sectors (e.g., utilities, infrastructure construction, health and education) than the private sector has done in "its" sectors (e.g., agriculture and manufacturing), the public sector has become increasingly more important in the total economy.

In terms of investment, gross fixed capital formation by private firms, in real terms, increased threefold over the 1973-1978 period. Since then, investment by private firms has declined; by 1982 it had fallen 21 percent from its 1978 level. The public sector now accounts for more gross fixed capital formation than private companies. The relative proportions were 55/45, private/public, in 1978, gradually shifted to 46/54 in 1982, and indications for 1983 were of a 33/67 ratio, a significant change. A similar relative decline in the formal private sector's contribution to gross value added is visible over a ten year period. Private sector firms in 1983 contributed an estimated one third of GDP.<sup>1/</sup> In the

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1/ The tables presenting this data are included as an annex to the author's report James Finucane, "Ecuador's Private Sector and AID's Strategy," December 17, 1983.

financial sector, the Central Bank, mainly through its use of rediscount mechanisms which move resources into the private productive sectors, is now responsible for half the total credit (up from 31 percent in 1970) and controls more than 40 percent of the system's assets.

During the 1970's, Ecuador's investment climate was good, demand was stimulated by petroleum revenues, and the government's policies and "indicative" planning approach presented minimal constraints and many incentives to domestic market oriented investments and to private, productive sector expansion generally. The explanations for the recent trend of declining private investment are partly external (petroleum price trends, deteriorating terms of trade for traditional agricultural exports, climatic conditions), but in good measure the explanations are the official strategies to deal with these external trends (increased public sector internal and external borrowing, increased attempts to manage the economy, both to control inflation and to promote development) combined with the hesitancy and lack of maturity of the private productive sectors (for much of the industrial sector, a product of the 1970's, the 1982-1983 period was their first sustained crisis).

The performance of the private agricultural sector merits a special mention. While interventions in private markets in the industrial sector have been intended primarily to promote growth, in the agricultural sector the intentions of the government until quite recently have been to control inflation and influence income distribution rather than encourage production. Agricultural sector producers in the 1970s suffered serious real price reductions due both to exchange rate and price policies. AID and IBRD analyses indicate that the performance of the GOE in the markets of the agricultural sector over the 1970's and early 1980's discouraged production, particularly among the more commercially oriented farmers.

The external sector crisis of 1982 and 1983 caused sharp rethinking of the role of private enterprise on the part of both the private and public sectors. The reaction of the private sector to the external sector crisis varied. Gross investment by private firms, in real terms, as mentioned above, declined; capital flight and speculative investment in real assets are reported by many to have occurred; private sector demands for the public sector to absorb the foreign exchange losses of the private sector ("sucretization" of private external debt) and for concessional credit to be extended by

the Central Bank were combined with demands for less state intervention in the markets. On the other hand, there were positive indications of increased dialogue between many public and private sector elements, including dialogue based on serious private investigations, one of which (the ANDE study) was financed by AID/Ecuador, of the structural nature of the crisis and a growing recognition by the private sector that a domestic and the Andean market focus has its limitations and, as with the 1983 closing of many Venezuelan markets, its considerable risk.

The government, in the context of the crisis, generally has adopted a positive stance towards private enterprise and since mid- 1981 has taken steps gradually to move towards a more market based economy. Interest rates were moved from negative to possibly positive levels (by March, 1984 the rates were again clearly negative), several devaluations were implemented, upper limit controls on foreign investment and profit repatriation were reduced, and a thorough study of effective protection levels, a necessary preliminary step for extensive further changes, was initiated. The current administration has worked closely with the IMF and IBRD on these changes. The extent of the changes has been limited by political realities in a country with one of the least equitable income distribution patterns in the hemisphere and by an element of mutual distrust, sociologically and historically based, between the public and private sectors.

Looking ahead over the medium term, the climate for the private sector appears "hazy", mainly because of the measures the government will be forced to take to manage its way out of the current crisis. Agreements achieved with the IMF and international banks during 1983 softened the immediate liquidity problem inherent in the private sector's debt servicing and proceeds from a IDB "reactivation" credit in 1984 should provide additional funds to cover the costs of imported industrial sector inputs. These agreements notwithstanding, the public sector will be taking a growing share of domestic savings while at the same time, given that significant new external commercial loans other than reschedulings can not be expected, implementing measures which will have the effect of holding down aggregate demand. At the beginning of 1984, Ecuador's private sector was in a difficult position and confronting the prospect of a more competitive future as the crawling peg devaluation continued, as subsidies and protection levels were being reduced, and as more restrictive demand policies were being implemented by the government.

## 2. Discussion

With the state now playing a critical role in setting development parameters for Ecuador, as is obvious most recently in the government's decisions not only on the rescheduling of public external debt but of private debt as well, the relations between the two sectors have become of great significance to both sides. In interviews and discussions with private sector leaders the heavy emphasis placed on the outcome of this year's election and on the government's external sector decision as conditioning investment decisions, many of which were said to have been postponed until after the elections, reinforced the importance of this public-private nexus.

Of the many observations which might be made on this topic, I will limit myself to three which, in my opinion, are important in considering any private sector strategy.

First, at the upper and immediately next levels of the government there are and have been many officials whose backgrounds are overwhelmingly private sector. At first glance this would appear to make for ready understanding between the sectors, or at least for ease of communication. While this undoubtedly happens in many instances, a strong characteristic is the feeling of distrust and lack of confidence in each other's competence which the sectors apparently share. An explanation which has been put forward is that the middle ranks of the public sector are staffed with individuals who, whether for political reasons or just sheer 'bureaucraticization', do not serve effectively to meet the minimum requirements of the private sector for setting and adhering to adequate 'rules of the game'. I sense that the problem is deeper than that, and that more attention needs to be addressed to it as part of an effort to consider constraints and opportunities in the private sector.

Secondly, partisan politics in Ecuador is a subject which does much to divide the private sector. It appears at times that within the private sector the differences amongst individuals which coincide with party lines were often exaggerated. One might say they take their differences very seriously. This is in one respect surprising in that, in spite of "right" and "left" labelling, the parties have tended to be non-ideological and, in class terms, cross-cutting. Partisan affiliations nonetheless strongly affect the ability of the sector to mobilize and express itself. Thus, certain organizations in the private sector which at one level have a

quite expected role (e.g., the promotion of exports) will be regarded by others as the mainly partisan vehicles of an opposing group. In the short term any development assistance programming undoubtedly will have to take these partisan splits specifically into account. In the longer term, one might want to consider supporting the development of institutional arrangements which strengthen the basis of non-partisan consensus within the sector.

Lastly, the current economic crisis with its social implications has served to instigate a very high (unusually so according to interviewees) involvement by organizations of the private sector in the debates about the nation's major decisions and directions. Amongst these organizations there is undoubtedly a hierarchy of status and respect, with the pronouncements of certain chambers immediately being the subject of national news reports and those of others relegated to obscurity. That is as to be expected. However, in my view, in a country such as Ecuador, with a very skewed family income distribution pattern, with distinctly community and geographic inequalities in income distribution, and with a rapidly growing political population, more attention needs to be paid to the organizations of artisans and small businesses, including those in the secondary cities, than is usually done. Otherwise, the base of the private sector consensus will remain small in absolute human terms and, at least as important if not more so, the problems and potential of the smaller scale sectors, with their capacity to produce jobs and output at lower per unit investment costs than the more 'established' sectors, will not be addressed appropriately.

#### G. Labor-Management Relations

Unions in Ecuador are a force with which private entrepreneurs must deal. As noted, in the abacá case in this report, some entrepreneurs organize units of relatively small size so as to be able to avoid reaching the minimum number (15) employees which would make them vulnerable to union organization of the work force. Entrepreneurs also have to contend with general strikes which, although not originating in the entrepreneur's firm, do negatively affect production. Over the year ending July 1983, there were seven to eight general strikes in Ecuador. <sup>1/</sup> Because of the government's

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<sup>1/</sup> This section is intended to give the reader a brief introduction to organized labor in Ecuador. Information is largely from a February 22, 1984, interview with Fred Becker of the US Embassy, Quito, from the Embassy's Annual Labor Reports, from interviews with employers and association leaders, and from newspaper reports.

many interventions in the economy which directly control wage levels and prices, the general strikes normally derive from labor-government rather than labor-private sector confrontations.

Unions, in a political party sense, are not influential in Ecuador. One of the best overviews of the development of the Ecuador political system, which included a full section on the development of political parties, discusses only briefly the role of unions.<sup>1/</sup> The major unions are not linked strongly with any particular party as they are, say, in Jamaica. In the January, 1984 elections, union leaders were on the tickets of the PD (Partido Democrático led by Francisco Huerta, a center-left party), FADI (Frente Amplio de la Izquierda, led by René Maugé, sometimes said to be Moscow 'linked'), the PSE (Partido Socialista del Ecuador, led by Manuel Salgado, said to be a communist party) and the Frente Nacional de Reconstrucción (led by Febres Cordero, the alliance of right wing parties). None of the union leaders were elected.

Unions in Ecuador lack a strong industrial base. Less than 15 percent of the economically active population is engaged in industry and construction and these sectors are not expected to be very dynamic in the next several years. The predominance of small firms with less than 15 employees in all the productive sectors further restricts their potential. The populist tradition in Ecuador politics not only has not been strongly tied to trade unions (as say in Argentina), but has created situations in which many gains have been given to labor (minimum wage increases, health and pension protections worker organization rights) by populist or paternalistic governments without having been achieved through labor organization and bargaining. Finally, widespread underemployment much of it in the informal sector, and growing open unemployment, make for a strong supply of labor into the modern sector which at least moderates any tendency to aggressive bargaining.

Individual entrepreneurs in interviews discuss labor "problems" in terms of government rules and regulations which affect wages, benefits, workday and workweek hours and not in terms of union demands or activities.

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<sup>1/</sup> Osvaldo Hurtado, El Poder Político en el Ecuador, Quito: Universidad Católica del Ecuador, tercera edición, 1979.

The major unions in Ecuador are:

CEOSL, the Confederación Ecuatoriana de Organizaciones Sindicales Libres, has been supported since its origin, twenty years ago by AIFLD, of the AFL-CIO, is said to receive assistance from the Friedrich Ebert Foundation, and is affiliated with the ICFTU. It is strong in Quito, Guayaquil, Manta, Portoviejo and Cuenca and claims 200,000 members. The US Embassy which, estimates CEOSL membership to be 115,000, quotes reports which indicate that "CEOSL is the largest and fastest growing labor organization among industrial workers." There is a CEOSL breakaway group which is headed by a former president of the union (Villacrés Araudi) which although small, has the affiliation of FEMAPOR, the stevedores union.

CEDOC, Central Ecuatoriana de Organizaciones Clasistas, is Ecuador's oldest (some 45 years) labor federation, and is associated with CLAT and the WCL (the Christian Democrat counter to the ICFTU and to the socialist WFTU) and receives assistance from the Konrad Adenauer Foundation (as does INSOTEC) While on reportedly good terms with the current government, it has supported general strikes against government decisions taken as part of the 1982-1984 stabilization program. It claims 150,000 members, 20 percent of whom are industrial. Its major affiliate is the petroleum workers federation. There is a breakaway CEDOC group of about 25,000 members which is lined up with the CTE and FUT (see, below).

CTE, Confederación de Trabajadores del Ecuador, is reported to be a communist linked union, affiliated with the WFTU and linked closely, at the national level, to the Ecuador communist party and the PSRE (Partido Socialista Revolucionario del Ecuador). It has probably 70,000 industrial members plus affiliates such as the Ecuador Indian federation (ECUARUNARI)..

FUT, Frente Unitario de Trabajadores, is a recent organization which, as described by the U.S. Embassy, "is a loose-knit collection of trade unions, campesino and student organizations that has promoted the idea of labor unity to pressure the government, with some sources, on a wide range of social, economic and political issues. Its key members, a very disparate group, are CEOSL, CTE and the breakaway faction of CEDOC.

FNC, Federación Nacional de Choferes Profesionales del Ecuador, is a politically unlinked but powerful organization which represents some 80,000 professional drivers and transport company owners. Government intervenes heavily in the markets of the transport sector, and the participation of the FNC in

various commissions which set transport sector policies has meant that this is a protected and privileged group.

## H. Economic Background

### Introduction

The recent Ecuador macro-economic context has been one of declining growth of output, rising inflation, rising external debt, falling investment, poor domestic resource mobilization and increasing public sector competition for domestic savings. The performance for the second half of 1983, however, subsequent to an IMF standby Agreement, produced significant indications, e.g. reduced public deficit, rescheduled commercial external debt, higher interest rates for domestic savings which reflected the government's recognition of the basis of the problem being one of structural maladjustment and its concomitant commitment to move toward a more market-based, external oriented economy.

The medium term macro-economic perspective for the Ecuador economy is for low growth of output and, if current structural adjustment intentions can continue to be successfully implemented, for reduced inflation, reduced public and external sector deficits, increased domestic savings and gradually rising investment levels. The major challenges, assuming the sustaining of the political will be to carry out the adjustment, will be the elaboration of correct policies and the management of their implementation during a period in which high external debt service requirements will severely restrict the government's economic and financial maneuverability.

In 1983, output of the Ecuadorean economy according to Central Bank estimates declined by 3.3 percent. While in part, this was a result of natural disasters which disrupted agricultural production and destroyed infrastructure on the coast, it represents a continuation of the longer term trend toward decelerating growth which has been evident since the late 1970s. From an increase of 5.3 percent in 1979, the increase in output declined gradually through 1981 to 4.5 percent and then abruptly to essentially zero and negative growth in 1982-83.

Exports and Balance of Payments. Over the nine year period 1974-1982 Ecuador's real (constant price) export earnings stagnated while the real value of imports increased by 33 percent. For the last six consecutive years of the period,

total real export earnings varied between 65 percent and 75 percent of the value of total imports. Ecuador had a negative balance on its current account for every year over 1978-1983. It averaged US\$780 million per year, roughly 35 percent of the value per year of exports over the period. This was covered mainly by net additional external medium and long term borrowing by the public (60 percent) and private (40 percent) sectors up to 1983. In 1983 the new borrowing was almost entirely (98 percent) by the public sector as part of negotiated steps to resolve what had become the external sector liquidity crisis. Ecuador's balance of trade for 1983 was actually very positive (US\$2.3 billion in exports versus US\$1.5 billion in imports) but it was achieved at the expense of severe import restrictions which contributed greatly to the fall in output and which, obviously, can not be maintained. The government is committed by the terms of the IMF Agreement (discussed below) to open importations by mid-1984.

The Ecuadorean balance of payments is dominated by the petroleum sector. In 1983, exports of petroleum and refined products accounted for 72.2 percent of total merchandise exports, up from an average 50 percent in the 1973-1974 period. The value of petroleum exports increased rapidly in the late 1970s and through 1981 on the basis of rising prices despite relatively stagnant levels of production. Domestic consumption rose rapidly under conditions of low prices set by the government and in 1982 petroleum exports fell 23 percent. This pattern was completely reversed in 1983 with Ecuador managing to increase the value of petroleum exports in the face of falling prices through a combination of increased production and restrained domestic consumption, an effect both of higher domestic prices and stationary or falling effective demand.

The performance of Ecuador's non-traditional exports has declined steadily since 1979. The accepted strategic objective of diversifying exports away from a dependence on a few commodities has not been achieved and the situation has worsened. Non-traditional exports declined to US\$362 million or 16 percent of total exports in 1983 as compared with US\$636 million or 29 percent in 1979. The only dynamic non-traditional sub-sector has been shrimp. Unit values and export volumes for shrimp are both increasing. Earnings from shrimp in 1983 were 42 percent higher than for 1982, and shrimp has become Ecuador's second (after oil) export earner. There were indications towards the end of 1983 that shrimp prices were beginning to weaken.

Ecuador's "traditional" exports - sugar, coffee, cacao, and bananas - have all performed poorly over recent years.

Sugar is now an imported commodity; coffee production has been fairly constant and though export income has moved up slightly in recent years, export prices have trended downwards; cacao production has fluctuated, cacao exports have declined dramatically, and world prices have steadily declined; and banana production has tended to fall off while world prices have been weak. All of these "traditional" exports have suffered the results of an overvalued, fixed exchange rate, in some cases export taxes, and generally rising production costs, some of which can be related to distorted factor markets.

Foreign exchange market. During the period 1971-1982, domestic inflation in Ecuador substantially exceeded that of its major trading partners, adjusted for changes in their exchange rates, while the rate of exchange of the sucre remained fixed on the official market at S/25 to the dollar. During the course of 1982 and 1983, the GOE responded to the balance of payments crisis by a series of adjustments to the foreign exchange regime. Ecuador has long had a free parallel exchange market, supplied by tourist expenditures and other non-merchandise export transactions. In May 1982, faced with a sharply depreciating sucre on the free market, the GOE devalued the official exchange rate to S/33 to the dollar. In November 1982, the GOE prohibited a long list of imports and announced that official foreign exchange would not be made available for many others. It also introduced a prior deposit requirement for most private sector imports. In March 1983, with inflation mounting, the sucre was again devalued (to S/42 to the dollar) and a crawling peg was instituted. In addition to constraints on imports, the GOE, in an attempt to stimulate exports, began to allow exporters of products other than petroleum to exchange a part of their receipts on the free market. According to the March, 1984 revision of exchange policies, non-petroleum exporters now receive 50 percent of their earnings at the free market rate of the Central Bank and 50 percent at the official rate. At the middle of March, 1984, the official exchange rate stood at approximately S/58 to the dollar, while the free market rate was moving in the range of S/85 to S/100 to the dollar. The expectations would be that with the success of a stabilization program and the continuing of the crawling peg, that the differential would narrow. Other factors, however, most likely domestic inflation and sluggish export production, may cause this differential to widen.

External debt. During the late 1970s and through 1982, the government undertook major external borrowings on the strength of expected future oil revenues. These more than covered the total public sector borrowing requirement thus

enabling the public sector to be a significant net lender to the domestic financial system. The Ecuadorean private sector also undertook significant external borrowings on its own account during this period, apparently on the basis of the lower nominal interest rates on these borrowings.

By the end of 1982, the external debt had reached true crisis proportions, totaling US\$6.4 billion dollars, roughly 47 percent of GDP, and debt service requirements for 1983 were greater than export receipts, with the gap projected to increase. The rapidly increasing debt service requirements on both public and private external debt, combined with falling export receipts (the value of total exports for 1982 was 16 percent less than for the previous year) forced government in 1983 to undertake a major rescheduling of both its commercial and (Paris Club) bilateral debt. The rescheduling was achieved at the expense of substantially greater debt service requirements during the period after 1984.

IMF Agreement. As part of the steps taken to resolve its external debt problem the government, on June 1, 1983, entered into a one-year Standby Agreement with the IMF. The Agreement's program involved reductions in the public sector deficit, narrowing and eventually eliminating the spread between the official and free market exchange rates, eliminating external payments arrears which had reached over \$600 million, and eliminating by the end of the program the direct controls on imports. On the basis of this Standby Agreement, the GOE was able subsequently to negotiate the rescheduling of over \$2 billion in official and private external debt and \$431 million in new commercial bank financing..

Performance during 1983 and early 1984 under the agreement has been impressive. On the fiscal side, the program called for a reduction in the consolidated public sector deficit from its 1982 level of 6.8 percent of GDP to 4.2 percent. Present estimates are that the 1983 deficit was less than 3.5 percent of GDP. On the level of international reserves the program called for reserves of US\$110 million to be held by the end of 1983; reported actual reserves at the end of the year were more than US\$150 million. Similarly, it appears that targets on domestic credit expansion and the term structure of public debt will be met. While the government did not succeed in eliminating all payment arrears by November 30 as programmed, these were reduced to less than US\$150 million and the short fall seems due mainly to an unexpected slowness on the part of creditors to supply fresh money.

Inflation. Prior to the oil boom, Ecuador was a low inflation country with price increases averaging well under 5 percent per year. Between 1973 and 1981, however, inflation averaged 13.8 percent and never fell below 10 percent. At the end of 1983 the annual rate of inflation was 48 percent. A major contributing factor to 1983's inflation was the El Niño disasters of 1983 and the food shortages that they produced. The food component of the consumer price index peaked at a monthly increase of 9.8 percent in June, due to food shortages resulting from the natural disasters, and subsequently fell sharply. A government study of inflation over the year ending July, 1983, indicated that although the national rate was 56.9 percent, it would have been 26.3 percent had the prices of agricultural products, both as food and as intermediary industrial inputs, increased at the same rate as other goods and services. The inflation rate for the last months of 1983 and initial months of 1984 was trending slightly downwards as more agricultural products reached the markets.

The prospect for 1984 and perhaps further is for reduced inflation (other things remaining equal) if the GOE is able to pursue its current policy direction. During the latter half of 1983, the rate of interest charged on loans in the informal financial market was reported to be 27 to 30 percent. Since the suppliers of funds to these markets presumably have the option of investing their funds abroad in dollar instruments, this, as well as a consideration of the temporary effect of the natural disasters, suggests that inflationary expectations and the underlying rate of inflation, is between 20 and 30 percent.

Savings mobilization. The availability of substantial amounts of external financing over the past decade permitted Ecuador to significantly expand credit expansion despite serious weaknesses in the domestic financial system. With the contraction of the external window, the weaknesses of the system became apparent. Ecuador's ratio of money and deposits to GDP, a measure of the overall level of savings mobilization by the domestic financial system, is among the lowest in Latin America. The considerable real growth of the 1970's was not associated, as is often the case, with any significant financial deepening. The low savings mobilization reflects the negative real rates of interest offered on deposits by the financial system and the previous unwillingness of the Ecuador government to shift to more market-oriented rates in spite of growing inflation. Although the upper limit on deposit interest was eliminated in 1982, rates are still effectively controlled by a ceiling of 19 percent (plus a 2 percent commission on loans with over two years maturity) on loans.

An additional series of credit and interest rate problems was created by the 1983 rescheduling of \$950 million in private sector external debt. In effect, the Central Bank provided a partial exchange rate guarantee for this debt, which is to be retired over a three year period. As this debt is repaid, borrowers will seek to replace it with domestic financial system credit. In addition, the closing off of most sources of external finance will require the domestic financing of much of the public sector's own borrowing requirement. The combination of refinancing of private sector external debt and a significant part of the (albeit significantly reduced) public sector deficit is likely to absorb all of the normal growth in domestic credit over the next several years. There is no clear prospect of any real credit expansion to finance new private sector investment.

Public deficit and borrowing. The fiscal situation improved in 1983 after having taken a dramatic turn for the worse in the early 1980s. The roots of the problem were oil. Since Ecuador began to export oil in 1972, the public sector grew increasingly dependent on this source for current revenues. In addition, during the 1970s the military governments borrowed aggressively from foreign commercial lenders to finance ambitious infrastructure projects. Between 1975-1981 the public sector deficit was entirely financed by external borrowing mainly from private banks. The external sector crisis of 1982-1983 caused a sharp deterioration in the fiscal situation (40 percent of public revenues came from petroleum in 1983). It brought into question ambitious central government plans and also those of the municipal governments which had allowed their own revenue generation to decline while enjoying oil-backed revenues from the center. The government reacted to the fiscal deterioration in 1982 and 1983 by taking steps to reduce expenditure (e.g., by lowering or removing subsidies), by raising some taxes, and by initiating efforts, with AID assistance, to improve its revenue generation efficiency.

In each year from 1976 through 1981, the government borrowed more than its deficit from external sources. The effect was that a significant portion of these external borrowings were used to expand domestic private sector credit. Unlike most developing countries, the government was a net lender rather than a net borrower from the domestic system during this period. This situation changed abruptly in 1982. With external financing sources drying up, the public sector began to make heavy demands on the domestic financial system,

equal to more than 2 percent of GDP. In 1983, however, the government, with external financing much tighter in 1983, managed to reduce slightly its domestic financing requirements.

Investment. Overall investment has remained relatively stable in recent years despite a large jump in public sector resources in 1980 and a sharp deterioration in the current account of the balance of payments in 1981 and 1982. However, this stability masks significant changes in the composition of investment. There was a significant increase in public sector fixed investment in 1980 which continued into 1981 as the government undertook a number of large scale investment projects which albeit appear to be, on the whole, well conceived and well executed. On the private sector side, there is an evident trend toward a decline in the proportion of output going to private fixed investment; from 13.0 percent of GDP in 1978 it fell to 8.9 percent in 1982. Real private investment levels have also declined.

Employment. Estimates on open employment in Ecuador, a nation which is still half rural and in which perhaps half the economically active population is either "own account" or family labor, are problematic. For the years 1974 through 1977, the World Bank, relying on official statistics, estimated open unemployment to be between 4.0 and 4.4 for urban areas and 2.2 to 2.3 for rural areas, with a national rate of 3.0 to 3.2 percent. In 1981, the official estimate of national unemployment rate of 5.0 percent. The 1982 Census preliminary results reportedly indicated a 5.4 percent rate. Whatever the precise figure, the trend is for increasing open unemployment. Estimates on underemployment are even more problematic. 1981 official estimates were that 24 percent of the economically active population in 1981 was underemployed. The rate for females (28 percent) was significantly higher than for males (22 percent). FAO estimates, indicate that as many as 60 percent of the rural labor force and 45 percent of the urban labor force are underemployed.

Demographic and social changes in Ecuador will have the effect over the next several years of increasing the economically active population at rates faster than that projected for population growth. While more refined estimates must await the release of more details from the 1982 Census, the expectation is for participation percentage rates to be in the mid-30's as compared to the high 20's of the 1974-1977 period. The agricultural sector will continue to be the largest single employer. The major growth in relative terms,

continuing the trend of the late 1970's, will be in the service sectors and, obviously depending on many factors, construction and industry. There were some reports at the end of 1983 that industry sector firms had begun to increase their employment, thus perhaps indicating the end of what was apparently a short-term decline. There were at the same time, however, reports that the industrial sector going into 1984 was on the verge of a large number of closings and reductions in employment because of the obstacles created by the shortage of imported inputs.

Population growth trends. Between 1974 and 1982 Ecuador's population grew at an annual rate of 2.67 percent according to the provisional 1982 Census results. This was considerably lower than the GOE estimated rate of 3.4 percent and thus Ecuador's 1982 population was 8.05 million rather than 8.95 million as projected. Rural population, however, grew at a rate (0.9 percent) which was slower than the expected while urban growth (4.84 percent) was unexpectedly rapid.

By the end of 1983 Ecuador's population was 50 percent urban and 50 percent rural as compared with a 28/72 urban/rural ratio in 1950. Guayaquil and Quito combined now have 2,000,000 inhabitants. The most important growth since 1974 has been in Ecuador's secondary cities on the Coast, particularly Portoviejo, Manta, Machala and Esmeraldas, and in other coastal (e.g., Santo Domingo de los Colorados) and Oriente (e.g., Lago Agrio) settlements. In contrast, population growth in the Sierra settlements has been slow and in several cases lower than the overall internal growth rate. The growth of the Coast follows the pattern clearly visible since at least 1950 and is largely due to the agricultural expansion of the 1960's and early 1970's. The Oriente growth is a result particularly of petroleum. AID analyses of fertility, mortality, migration and employment rates among the different population centers indicate that the major factor in the differential growth rates has been rural to urban migration with destinations strongly influenced by beliefs of the existence of employment opportunities.

The population growth perspective for the medium term period is for continued moderately high growth in the absence of a clear national population policy. Religious and cultural factors, together with vocal anti-family planning elements, make population control programs in Ecuador extremely sensitive. Nevertheless, demand for family planning services is high and the recent census indicates that low-key, behind-the-scenes efforts are beginning to have some results,

but not yet to the degree needed. The trend for growth to be especially accelerated in secondary coastal cities can be expected to continue.

Agricultural sector.<sup>1/</sup> The performance of the agricultural sector since 1970 has generally been disappointing. During the 1970's production of the main agricultural products expanded at an annual rate of two percent although there were significant differences in performance between commodity groups. Overall, production of export crops and raw materials increased by about three percent and 12 percent per annum, respectively while food crop production, in the face of an annual population growth of 2.67 percent, declined by more than three percent annually. The more recent export crop trends have been negative (see p. 52 above). Productivity in the agricultural sector has remained generally stagnant at low levels. Except for bananas and oil palms, yields have remained stationary for all major crops since 1975. Average yields are 30 percent to 75 percent less than those obtained by the more advanced farmers using improved technology and having access to extension, credit and marketing. Ecuador's marine products sector includes fresh and frozen shrimp, tuna, sardines, mackerel and others along with canned fish, fishmeal and fish oil. The U.S. is the main shrimp market while the other products go principally to Asian and other LAC countries. Except for shrimp, marine production (9 percent of which is exported) slowed during the early 1970's. Ecuador's tuna was banned from U.S. markets from November, 1981 to March 1983 because of a coastal fishing limits dispute.

Food. The steady decline in food production combined with an estimated growth in food demand of five percent per year led to sharp increases in food imports (an average annual rate of increase of 13 percent in real terms) over the 1978-1981 period. The national decline in food production, the decline in real prices for the rural sector's agricultural products, the growth in population, the decline in cropped area dedicated to subsistence food consumption, and large and perhaps increasing income distribution disparities, are trends which when combined indicate a growing food crisis, especially

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1/ Joe Goodwin, AID/Ecuador's rural development officer, in early 1984, produced a general overview of the agricultural sector, which included a review of institutional problems.

for the poor in Ecuador. The most recent food balances prepared in 1974, indicated deficits in all categories, except fruits. Nutrition surveys have revealed major diet deficiencies in calories, proteins, fats, and certain minerals and vegetables. While there is a need for updated and improved food balance tables and nutrition surveys in order to arrive at actual figures, taking 1974 as a starting point and considering the trends and findings noted, the conclusion is that food supply has become a critical issue.

Petroleum and the Energy Sector.<sup>1/</sup> With the GOE setting domestic petroleum product prices well below world prices, domestic consumption (including clandestine exports to neighboring countries) of conventional energy products (petroleum derivatives and electricity) in Ecuador grew faster (13 to 14 percent per year) during the decade preceding 1981 than in virtually any other country in the world. During 1981 and 1982 the rate of growth slowed to an average five percent annually. Most of the increment was in transport fuels and electrical lighting. While price increases have been significant in sucre terms (500 percent from January 1981 to December 1983 for 80 octane/regular gasoline), real price erosion due to dollar devaluation and inflation left domestic petroleum prices at the end of 1983 at 20 percent of average world prices, using the free exchange market for dollars. It is also notable that from 1974 to 1982 the number of households using LPG for cooking, grew from 6 percent to over 35 percent and that according to the 1982 census over 45 percent of the households in Ecuador still use fuelwood for most of their domestic energy needs. Many rural small industries, such as, ceramics, bakeries, brick kilns and certain food processing remain dependent on woodfuel.

At the present time, Ecuador's proven reserves are estimated at 1.1 billion barrels. At current production rates, these reserves would last about 14 more years. Although Ecuador is believed to have additional petroleum reserves, its ability to carry out explorations and development were severely limited until recently by the personnel and financial limitations of CEPE, the state oil company, and by lack of interest by foreign oil companies in exploration and development due to contract terms for foreign oil firms which were significantly more restrictive than those of other Latin American oil producing nations.

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<sup>1/</sup> These comments on energy are taken from an early 1984 sector review prepared by Carl Duisberg, the Quito based AID Regional Energy Advisor.

Manufacturing sector. The Ecuadorean manufacturing sector is characterized by recent low growth and a heavy dependance on imported inputs and tariff protection resulting from long standing policies of import-substitution industrialization. In recent years, the rate of growth in a number of manufacturing subsectors has declined sharply as the growth potential of the domestic market (and the Andean Pact market) has been largely exhausted and because of Ecuador's shortage of foreign exchange. There was a gradual deceleration in industrial growth from 10.2 percent in 1970-77 to 7.4 percent in 1978-81 and to 4.6 percent and minus 5.6 percent in 1982 and 1983, respectively. Manufacturing's contribution to total GDP has remained fairly constant at 18 percent for the past five years.

Ecuador's industrial sector relies on imported materials and capital goods and carries a high level of external debt. Industrial exports for 1982 were equivalent to less than 74 percent of their external debt, and 1983 exports were 50 percent below their 1982 level. The structural nature of the problem is evident: 35-45 percent of the value of manufacturing output is represented by the value of imports of raw material, intermediary products and capital goods while only 17 percent of the value of manufacturing output is exported.

It is possible to overstate the degree of the distortions in Ecuador's industrial sector which have resulted from the application of the import substitution strategy. First, the principal instrument for industrial protection has been tariffs rather than direct controls on imports. While relatively high tariffs on output, combined with exonerations of tariffs on inputs, have produced fairly high levels of effective protection, they have not produced the kind of extreme distortions of the industrial structure which have resulted from direct controls in other countries. Second, protection was undermined by the progressive appreciation of the sucre between the mid-1970s and 1982 and perhaps by smuggling from neighboring countries. Thus import substitution has been less effective, hence less distorting, than it might have been.

Ecuador's import substitution strategy tended to promote capital (both human and physical) using activities at the expense of activities intensive in unskilled and semi-skilled labor. However, in many countries there are other, more significant obstacles to efficient utilization of the labor force, including minimum wage and other labor legislation. In

Ecuador, many private sector leaders point to public sector interventions in the labor market as a key aspect of the capital intensity problem. They assert that the doubling in nominal terms of the minimum wage in the past two years and the 1981 change from a 48 to 40 hour week have adversely affected profitability. On examination, the national accounts indicate that it was actually factor payments to capital in the private sector as a proportion of value added which grew substantially during the 1980-1982 period while the participation of wages and salaries (including statutory and non-statutory benefits) actually decreased. Considering specifically the case of corporations and limited companies, one finds that remuneration declined from 39.6 percent of value added in 1980 to 30 percent in 1982, while payments to capital rose from 52.3 percent to 65.8 percent.<sup>1/</sup>

The wage increases of recent years should be viewed in light of the 1970-1978 period during which minimum compensation increased by 13 percent in cost terms while productivity in industry increased 60 to 70 percent. Labor costs in Ecuador, according to a recent IBRD report, however, do seem to be high in comparison with other Latin American and Caribbean countries (when viewed in relation to per capita income) and it is possible that Ecuador based firms may have lost some potential international competitiveness in recent years due to the GOE's labor market interventions of the manufacturing sector is concentrated both by units and geographically.

During the intercensus period of 1974-1982, urbanization increased at a faster rate than expected with the fastest growing cities being Portoviejo, Manta, Machala and Esmeraldas. 50 percent of Ecuador's total population now lives in urban centers. The relatively faster growth of the secondary (the above four plus Cuenca and Ambato) and other cities underscores the geographic concentration of private sector non-agricultural productive activities in Quito and Guayaquil (these cities have 52 percent of Ecuador's urban population but 89 percent of manufacturing sector employment). Out of a total of 1,700 to 2,300 formal sector firms with an average of 50 employees each, 200 of them contributed 67 percent of value added in 1977; 5 percent of the firms in 1978 controlled 72 percent of invested capital. Informal or workshop based manufacturing in Ecuador, defined as having less than seven employees, has gradually given way in importance to

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<sup>1/</sup> The data for these calculations is included as an annex to, James Finucane, "Ecuador's Private Sector.....," op.cit.

larger, more formally organized economic units. Figures available for 1978 indicate only 20 percent of value added in manufacturing was contributed by workshops. On the other hand, 60 percent to 70 percent of the sector's employment was contributed by this sub-sector. In the formal sector, the fastest growing sub-sector, in terms of production, productivity and employment has been the small scale group, defined as having 7 to 20 employees. Geographically, Guayas and Pichincha based firms contribute 81 percent of manufacturing value added.

### III. Sectoral Reviews

#### A. Weak Institutions

The weakness of institutions (as organizations) continues to be one of Ecuador's main constraints on development. Institutions lack the necessary qualified personnel to conceive and implement the policies and programs which support socio-economic development goals to coordinate development activities to develop, adapt, and diffuse appropriate technologies; and to utilize effectively limited resources. At the central level public institutions often lack the information necessary to carry out rational policy decisions. The lack of adequate management information systems contributes to the reluctance of high level authorities to delegate responsibility and, consequently, to the marked over-centralization of governmental authority in Quito. Resource mobilization capacity, especially revenue collection, is notably weak.

At the provincial, regional, and local levels, municipalities and other decentralized organizations have the legal authority to make decisions on their own development problems. However, the necessary resources are concentrated in central institutions, a tendency which was reinforced by the oil boom. Moreover, local government personnel are generally unqualified and their outlook tends to be parochial. At the same time, national level organizations responsible for promoting municipal and local level development lack the technical capacity to respond to the needs of decentralized organizations such as the municipalities.

Private sector institutions are affected by the same human resources constraints that affect public institutions. Significant training needs exist. The demand for qualified managers in private enterprise far exceeds supply, and many managerial positions are filled by persons who are not properly trained. Quality graduate management programs are virtually non-existent. At the technical level, vocational schools are generally underfunded, poorly staffed, and unresponsive to labor market needs. The government has a specialized vocational training program, but its facilities are costly and limited. Finally, the private sector is well aware of this problem but lacks the capacity and support to address it effectively.

The following three sectoral reviews of the private sector indicate the need to strengthen the capacity of private productive sector representative organizations (chambers, associations, etc.) to interact effectively with the public sector on policies and sectoral issues and to provide services to their members. The relative weakness of the policy dialogue capacity of the private organizations has been a factor in the policy formulation context which is the more noticeable as the government attempts a more market-oriented style of economic management.

The weakness of institutions in the wider sense, that is as established patterns of behavior, rather than as organizations, in relation to the needs of a more efficient market oriented economic system in Ecuador are many, for instance: public organizations and private orientations which have developed in response to national and Andean Pact import substitution policies (as well as sheer import restrictions) now exist in strength; institutional capacities to mobilize

long term domestic resources are largely underdeveloped; non-commercial service delivery structures in the public sector (e.g., those for buying, storing and selling basic commodities, those for assisting exporters, those for providing technical and training services to industry) continue to show a growth tendency; socio-cultural patterns exist which limit private sector management efficiency (e.g., excessive use of ascriptive criteria for top management selection; a tendency to centralize decision-making); there is insufficient installed human resource development capacity to ensure an adequate supply of trained management (management training has been identified as a bottleneck in two AID/Ecuador financed studies) and skilled technicians; there is a low level of acceptance by the private sector of the social responsibility of the private business sector; and, there is a resource allocation bias in favor of large-scale units reinforced by socio-cultural orientations and by administrative procedural requirements.

A final institution weakness, which works to constrain efforts to achieve a more balanced distribution of the benefits of economic growth, is that in spite of governmental and private efforts, the poorer segments of the population remain largely unorganized and powerless. They are often functionally illiterate, inarticulate, and ignorant about the processes and vehicles they could use to influence public policy and to obtain services and resources which might improve their socio-economic situation. When there have been attempts to mobilize the poor, the highly paternalistic nature of these efforts (e.g., past activities in cooperative formation among agrarian reform beneficiaries) has often doomed them to failure.

## B. Sector Analysis - Non-traditional Exports

### 1. Sector Definition

"Non-traditional" exports are those exports other than oil and oil products, banana (and plantain), coffee, cacao and sugar. This is the non-traditional sector that FOPEX, Fondo de Promoción de Exportaciones, addresses as well. In the case of FOPEX the definition originally, circa 1972, derived from a combination of criteria including volume exported, length of time as a major export, and the type of agreements under which the exports were made (i.e., many of the traditional exports are based on quotas and international agreements). Sugar is a somewhat special case, having been a major primary agricultural export, and thus excluded from FOPEX and others programs

intended to promote non-traditional exports, which has recently become an imported commodity. The sector, thus, includes the manufacturing sector, except for petroleum products, the agro-industry sector, and the primary agricultural sector except for the traditional major export crops. As so defined, this is the broad, non-traditional export sector that is the major focus of Ecuador's attempts to diversify and expand exports as a key element in its development strategy over the 1980's.

## 2. Sector Size and Contribution

In the economy of Ecuador the non-traditional exporting sector is small. According to the result of MICEI survey, a total of 260 firms<sup>1/</sup> were exporting non-traditional products from Ecuador in 1980, a number which in terms of firms and products likely had been reduced by more than half by mid-1983. In the primary sector, non-traditional exports were five percent of the value of total primary exports. In the industrial sector, 1.1 percent of all manufacturing enterprises were exporters. While MICEI's figures serve to indicate the relatively light contribution of the sector in the Ecuador economy, their preciseness is not necessarily accepted. It was not possible to review any of the original material of the MICEI survey, and thus the definitional limits of the sector are not completely clear. Also, in the case of one sub-sector (abacá, see case study) the figures reported in the survey are clearly in error. Finally, there is much inconsistency in the details (as opposed to the totals and the broad overview) between these figures and those reported in a U.N. study which was based on a review of the 1980 export licenses awarded by the Central Bank.<sup>2/</sup>

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1/ MICEI, "Encuesta de la Oferta Exportable de Productos No-Tradicionales", 1980. The results of this survey were reported briefly in the 1983 report to the legislature of the Minister of MICEI, "Informe de Labores Agosto 1981 - Julio 1982", and in more detail and with an analysis of some of the findings in, CENDES, "La Producción Manufacturera Exportable e Identificación de Industrias de Exportación en el Ecuador", 1983.

2/ See, PNUD, "Comercialización Internacional de Productos Ecuatorianos", Quito, Octubre 1981.

Official MICEI figures, presumably based on national accounts data, indicate that 4.3 percent of the gross product of the manufacturing sector was produced by exporting firms in 1980. On the other hand, industrial enterprise survey data compared with export statistics for the same year, indicate that the value of non-traditional manufactured exports represented an estimated 17 percent of the total value of manufacturing output. Whatever the contribution, 35-45 percent of the value of manufacturing output was the value of imported raw material, intermediary products, and capital goods for the sector. The situation has worsened in the intervening years, with both manufacturing production and manufactured exports declining as a percentage of manufacturing production.

Of the exporting firms in the industrial sector, 77 percent were located in either the Quito or Guayaquil area. In total, export firms employed 31,000 people, 10 percent in the primary products sector and 90 percent in the manufacturing sector. This represented 0.1 percent of Ecuador's total economically active population. In the industrial sector, nine percent of the labor force was employed in firms which export.<sup>1/</sup>

### 3. Sector Development

Prior to 1970, Ecuador exported a few, major agricultural commodities -- bananas, cacao, coffee, sugar -- and had a very small manufacturing sector. During the 1970's petroleum resources were developed, petroleum quickly became the major export commodity, and an industrial sector grew rapidly based upon import replacement. The industrial sector in 1980 was producing in gross volume terms, 252 percent of the output recorded in 1970.<sup>2/</sup>

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1/ CENDES, "Datos Básicos para Inversiones Industriales en el Ecuador", 9182, p.105.

2/ See Banco Central del Ecuador, Boletín, No. 584, 1982, p. 355.

By the early 1980's, it was widely accepted in Ecuador that future economic growth would require an approach based on diversification of exports, the development of export-oriented industries and a movement away from the by then discredited input substitution strategy. Ecuador's 1980-1984 national development plan<sup>1/</sup> marked the clear, if not whole-hearted decision by Ecuador to adopt a more export-led industrial development strategy. While not completely discarding the import substitution approach, the structural nature of the problem-- "no diversified export base has been established nor has there been a significant import substitution process"-- was recognized and a general objective was set to gear manufacturing output increasingly to foreign, especially Andean Pact<sup>2/</sup> markets. Some of the problems which exist today, such as the underutilization of installed capacity, growing dependence on imported imports, technological backwardness, capital intensity and fiscal losses, were obvious in 1979-1980. The Plan pointed out that if there were not a strong increase in non-traditional exports and a relative reduction in imports, "the economy will run a grave risk indeed." No particular attention was paid in the Plan to the role of the private sector in increasing exports.

By early 1982, with Ecuador facing an external sector crisis, the promotion of exports had become "the fundamental objective" in the economic and social stabilization program put forward by the Monetary Board.<sup>3/</sup> The Board's analysis of the development and structure of Ecuador's economy pinpointed the source of Ecuador's crisis as being the failure to expand exports in a diversified fashion, a failure related to an industrialization strategy based on protected internal markets rather than on international prices, competitive products and comparative advantages. The Monetary Board reported a few steps which had been taken in 1982 to promote exports-- devaluation to increase the competitiveness of Ecuador's products and the making available of equity capital (through FOPEX) for investment in firms which would try to expand their

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1/ Republica del Ecuador, Plan Nacional de Desarrollo, 80-84

2/ The Andean group is composed of Bolivia, Peru, Ecuador, Colombia and Venezuela.

3/ Banco Central del Ecuador, "Programa de Estabilización Económico y Social", Julio, 1982.

exports or enter for the first time into the export sector. It also stressed that additional steps were necessary to strengthen non-traditional export sector;

- the gradual reduction of protective tariff barriers so as to improve competitiveness;
- the establishment of a new legal structure for the promotion of exports;
- the formulation of a clear policy framework for export promotion (including encouraging the establishment of private associations or trading companies specifically for exports); and,
- the passing and implementation of an export insurance law.

With the exception of some tariff adjustments, none of the above mentioned steps were implemented as of early 1984, although various bills had been introduced in the legislature. In the current revision of the national plan,<sup>1/</sup> industrial development strategy is centered on a broad and essentially unfocused discussion of external commerce. The import substitution program is seen as requiring a "selective advance", which would include the "reorientation" of import substitution industries, so as to be able to assist in earning foreign exchange. And under the objective of strengthening the balance of payments and Ecuador's international monetary reserves, a long series of general actions are proposed so as to increase exports and to restructure the export base away from its dependence on a few primary products. Those are similar in intent to the thinking of the Monetary Board and include increasing productivity, improving quality, upgrading transportation and infrastructure facilities and putting more emphasis on export promotion.

The major actions taken over the 1979-1983 period which have affected Ecuador's exports are of two kinds:

- those intended specifically to encourage exports; and
- those taken for other reasons which have had, in most cases, a possible negative impact on non-traditional exports.

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1/ CONADE, Reajuste del Plan Nacional de Desarrollo para los años 1983-1984, Enero, 1983.

Of the first group, measures intended specifically to promote non-traditional exports, one can distinguish between those in the fiscal, financial, monetary, and exchange areas from others more institutional or procedural in nature.

Prior to the March 1983 devaluation (see below), the major actions were:

- on the fiscal side the, April, 1981 amendment to the regulations governing the operation of the export tax credit program,<sup>1/</sup> which in essence assured a 25 percent tax credit for non-traditional exports and which was subsequently reduced in October, 1982;
- on the financial side the continued extension of ample credit at preferential interest rates to exporters through FOPEX, the sui generis program of the Central Bank and the provision of finance for equity participation in firms intending to expand or enter export markets;<sup>2/</sup>
- on the monetary side, a series of changes affecting credit availability none of which presented serious obstacles to exporters;
- and on the exchange side, beginning in March, 1982, with the first significant move away from the fixed exchange rate of 25 to US \$1.00,<sup>3/</sup> the implementation of a complicated policy of several tiers of exchange rates, basically intended to restrain imports and encourage exports.

At present, the situation is governed, by the measures which the government took in March, 1983. The official sucre was devalued from sucres 33 to sucres 42 to US \$1.00 and a crawling peg system of automatic daily mini-devaluations was established (as of March, 1984, the official rate had reached sucres 58 to US \$1.00); a "free market" for Central Bank interventions was established which enables the non-traditional exporters to receive 30 percent (changed to 50 percent in March

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1/ Ley de Abono Tributario, See, Decreto Ejecutivo No. 993, published in the Registro Oficial, No. 410, April 1, 1981.

2/ The March 3, 1983 resolution of the Monetary Board, assigned \$500 million sucres for investment in such firms.

3/ There had not been a devaluation as such in ten years, although beginning in May 1981, the Central Bank's strong "interventions" in the free market, resulted in a devaluation in effect if not in name.

1984) of their export earnings converted to sucres at this rate (which is currently running at 95 percent of the private free market rate) and 70 percent (now 50 percent) at the official rate, the interest rates for export financing were raised from 12 percent to 13 percent, and the system of export tax credits was programmed for abolition, and export finance as a percentage of value of exports was reduced slightly to 75 percent.

Institutionally major public sector actions in terms of changes were limited over the 1979-1983 period. Studies were carried out on measures to reduce "red tape" in the export documentation process (recommendations were accepted but not implemented), a bill presented (it has not been passed) for providing export insurance, and a bill has been presented for a new, export promotion law. There have been minor rearrangements within MICEI but otherwise no significant organizational changes. The allocation of responsibilities and the focus of initiatives have remained constant.<sup>1/</sup>

Of the actions which have had negative effects, some private sector spokespeople have pointed to the increased cost of imported inputs, the increased cost of fuel and transportation which followed the removal of petroleum subsidies beginning in 1981, and increases in labor costs following steady raises in minimum wages levels and reductions in the length of the work week. Interviews with individual exporters, however, did not reveal any great concern on their part over a reduction in price competitiveness as a result of these measures. Upon a review of the actual export performance and calculations as to the effect of different measures on cost structures, the conclusion is that the impact of the 1980-1983 decisions, in the total, has not been significant in that they have not been sufficient to reduce the decline in non-traditional exports.

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<sup>1/</sup> For a full description of the general structure, see, G. Fernandez, "Regimen Jurídico Institucional del Comercio Exterior del Ecuador," PNUD, November, 1981.

4. Sector Trends

The performance of Ecuador's non-traditional export sector has declined steadily since 1979. The strategic objective of diversifying exports has not been achieved and the situation has worsened in both current and real terms, as can be seen in the following chart:

(US\$ bn, current price)					
<u>Non-Traditional Exports</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>
- value (FOB)	.636	.714	.623	.541	.367
- as % of total exports	29	28	25	25	16

Source: Central Bank figures. The 1983 figure is a flat projection based on the performance over the first six months of 1983. It probably underestimates the decline.

The situation can properly be classified as critical because within the traditional group, with the exception of oil, the performance of the major products has been equally poor:

banana

-banana exports by volume ranged over the 1979-1982 period, from 1,229.6 to 1,437.2 million kilos. They are now running at 1,010.2. Unit prices have ranged from 14.40 c/ to 16.90 c/ per kilo, and are now at 15.70 c/.

coffee

- coffee exports by volume ranged over the 1979-1982 period, from 82.0 to 53.9 million kilos and are now running at 86.6. Unit values ranged from \$3.17 to \$1.88 per kilo. They were at \$1.70 for the first five months of 1983. The price trend over the entire period has been steadily downwards.

- cacao  
annual cacao exports by volume over the 1979-1982 period, ranged from 13.7 to 42.5 million kilos, and are now running at a 13.0 million kilo level. Annual unit values have ranged from \$2.82 to \$1.48. They have fallen to an average of 1.43 for 1983. The price trend over the entire period has been steadily downwards.
  
- oil  
oil exports in 1983 accounted for 72 percent of Ecuador's export earnings. Exports by volume ranged over 1979-1982 from 46 to 34 million barrels. They are now running at 70 million barrels. The unit value has ranged from \$23.4 per barrel to \$35.2, and is now at \$29. The price trend since 1980 has been downwards. Unit costs of production have moved steadily upwards for \$0.83 in 1979 to \$1.99 in April of 1983.<sup>1/</sup> The current volume reflects what will apparently be a medium trend of increased production.
  
- sugar  
sugar is now an imported commodity in Ecuador.

Within the non-traditional group, the only dynamic sub-sector has been shrimp. Unit values and export volumes for shrimp are both increasing. Earnings from shrimp in 1983 were 42 percent higher than 1982's total of 130 million dollars, and have become Ecuador's second (after oil) export earner. Otherwise, the non-traditional group, by 1983 had assumed staggering proportions. In comparison with 1982 performance, the important sub-sectors are all in sharp decline- fish products, down 75 percent; cacao products down 33 percent; electrical appliances, down 98 percent; coffee products, down 49 percent.

The principal non-traditional export products from Ecuador have been: chemicals and pharmaceuticals, cacao products, instant coffee, frozen, tinned and processed fish products, tea, abacá fibre, wood and wood products, vegetable oils, domestic electrical appliances and panama hats. The principal markets have been over a ten year period, the U.S. (33 percent) and the Andean Pact countries (30 percent).

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1/ "Revista Económica", 8/83.

Within the latter group the two principal markets have been, Venezuela and Colombia. The recent trend, however, has been for the U.S. market to increase in importance (it was the destination of an estimated more than 60 percent of the 1983 non-traditional exports) because of the continuing dynamic performance of shrimp and the continuing difficulties in inter-Andean trade. In 1983, an estimated US\$35 million entered the U.S. under the General System of Preferences.

### 5. Analysis and Comment

The very briefest of reviews of the non-traditional export sector in Ecuador over the past five years reveals that the performance trend has been negative. Secondly, actions taken in a variety of policy areas have not been sufficient to reverse this trend. Thirdly, no institutions or procedural changes of any significance have been made during this period. And, finally, that a broad consensus exists on the broad scope of measures now needed.

With regard to the public sector, the announcements of plans, strategies, new emphases and efforts in this sector often appear to be made prior to any of the necessarily detailed professional and technical work. That would be one explanation for the lack of major, structural changes in the face of continuing major announcements. Another might be that the government has been forced, because of the severity of its foreign reserves crisis, to increasingly view the entire export sector in terms of short-term reserves and management requirements. Thus, instead of structural changes, government has engaged in a continuing series of adjustments.

It is noted that the only dynamic sub-sector within the non-traditional group (shrimp) has prospered for reasons of external market (increasing demand) and local private initiatives (mainly investment) and not because of any particular public sector actions,<sup>1/</sup> rather than any particular public sector action. Equally, the external market

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<sup>1/</sup> Government officials do assert that their quality control, through sample selection, has increased marketability. Exporting firms give this new no credence.

situation (Andean Pact trade barriers, reduced international trade and world recession) has been the factor which has negatively affected the rest of the non-trationals.

With regard to the private sector, and in spite of the insistent efforts of FEDEXPOR, there has been a relative lack of collaboration either within the sector or between the sector and the government. This is explained in Ecuador in a variety of ways (reasons from psychological to partisan politics were suggested in interviews) none of which, to this observer, seem to be totally convincing. The basic feature seems to be a certain element of inertia, made possible and encouraged by a broadly protectionist regime and not countered by any sufficiently strong institutionally based pressure to act. In the face of the negative performance trend (which is related to structural problems) and the successive monetary crises (partly due to short-term phenomena, but structural in origin), the private sectors main efforts have been devoted to unrealistic (e.g., sucretization of the private sector external debt and thus the shifting of the exchange risk to the public sector) or short-term measures (e.g., refinancing of company debt on concessional terms with funds originating in the public sector) and not to the implementation of structural change.

## 6. Components of Sector's System

a. Export Finance. Export finance appears to be amply available and, at least in some instances, has been underutilized in Ecuador. It has been suggested in interviews that total export credit provided is more than the 75-80 percent of the value of exports, the limit intended by the Central Bank. The explanation would be a combination of, i) under-invoicing of exports - so as to receive dollars directly in non-reported foreign accounts and thus to avoid their being exchanged at the official rate; and, ii) over application to export credit lines so as to receive concessional credit for other activities. None of the persons interviewed mentioned financing as a constraint. In the case of new exporters, there is, however, a difficulty in completing, for the first time, the documentation process required to secure exporter status. There is a concentration of export finance in a limited number of products and firms, but with an apparent surplus of export credit available this has not attracted negative comment.

The fact that exporters pay for imported (most of which are on "Lista II") inputs with foreign exchange purchased at high prices (i.e., at the free market rate) while the Central

Bank converts their export receipts into sucres at only a portion of the free market price (82 percent in March, 1984) has been an issue for many exporters. The shrimp exporters have been especially active in trying to change this policy. It is undoubtedly a policy which contributes to the underinvoicing of exports. The effects of the exchange rate system are being studied in detail in a World Bank financed study which is examining the broad array monetary, exchange, fiscal and financial policies which condition the competitiveness of Ecuador's products. The study will be completed in late 1984. At least until the results are available and have been considered, one can expect a continuation of the present series of incremental adjustments in these areas which directly and indirectly affect export financing.

The major credit lines are those of FOPEX and the Central Bank's sui generis funds. Others are the Corporación Andina de Fomento and the less specialized lines of CFN, the financieras, and commercial banks.

FOPEX. This institution, the part of the CFN which is entirely dedicated to non-traditional export financing, provides pre-exportation and post exportation credit and has the capacity to make equity investments. In 1981 it provided credit of US\$ 87 million (calculated at US\$1.00 - 25 sucres) equal to 20 percent of the value of non-traditional exports. It provides a full range of services from working capital and market survey financing to the discounting of letters of credit and certificates of deposits. Its terms are concessional currently at 16.25 percent (13 percent from the Central Bank plus FOPEX's 3 percent and 0.25 percent for a cancer research fund) per year for 75 percent of the value of the exports for a maximum period of 360 days. FOPEX reports that, as a rule, 40 percent of its financing goes to cacao products (it was 35 percent in 1981), 15 percent for fish products, 10 percent for coffee products and 10 percent for animal feed. Of the \$500 million sucre which has been available to FOPEX since March, 1982, for investment in firms which are expanding their exports or entering into the export sector, \$65 million had been taken up as of September, 1983.

Sui Generis. These are credits provided through the private banking system, by the Central Bank, for both traditional and non-traditional exports. They are provided against the guarantee of a bank or financiera. The terms are

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similar to FOPEX in their concessionality, but the rate is 17.25 percent (the one percent difference being tax) and the period is 180 days. It is estimated (by FOPEX officials) that sui generis credit lines finance 53 percent of the value of non-traditional exports.

SAFICO. The Sistema Andino de Financiamiento de Comercio is the inter-Andean export financing vehicle of CAF, the Corporación Andina de Fomento. SAFICO provides financing to both importers and exporters. In Ecuador SAFICO operates under an agreement between CAF and CFN, under which the credit funds are drawn equally from FOPEX and SAFICO. In 1981 credits extended totaled US\$0.84 m; they were mainly used for processed fish products and domestic appliances to Venezuela and electrical tools to Bolivia. Because of the difficulties in inter-Andean trade caused by protective measures taken by the member countries, the SAFICO credit line is currently reported as not active. FOPEX and CAF indicate, in general, that demand for this credit line is weak.

Others. The private banking system does provide export financing, at rates of about 20 percent, and it appears that at least some of the major exporters use these lines along with employing their own funds presumably because it is part of the total package of commercial banking services being provided (FOPEX estimates that this may account for 15 percent of export financing). On the production side, there is a wide array of financial services at concessional rates available to exporters CFN and the financieros.

b. Export Insurance. Insurance for Ecuador's exports is arranged through private insurance companies. The foreign importer normally is responsible for coverage once the product has left the plant or has been loaded at the port of embarkation. The need for a program which would provide wider and varied types of export insurance has been widely recognized and agreed upon, within the public and private sectors, at least since 1980. A law was introduced into the legislature in 1982, but has not as yet received the required second reading, and it is not scheduled to receive it. The explanation seems to be that the government, facing difficulties in the legislature, has put higher priorities on other legislation and neither the opposition parties in the legislature nor the private sector groups outside, with the exception of FEDEXPOR, have considered it of sufficient importance to be lobbied for. Export insurance is now covered in the proposed new export promotion law.

c. Fiscal Incentives for Export. There are no fiscal incentives now applicable to exports. The former system of CATs (certificado de abono tributario) was abolished in March 1983, with the devaluation. The CATs had been awarded, in principle, on the basis of domestic value added. In practice, there was an administrative determination of value added which took into account labor intensity, difficulties of market access, Andean ties and other factors, which resulted in the qualification of virtually all non-traditional exports. In 1980, the largest earner of CATs (S/561 million, or 67 percent of the total of S/842 million) was the fish and fish products sector. Over the 1970-1980 period, the two major earners of CATs were the fish and fish products sector and the cacao products sector.<sup>1/</sup> The proposed export promotion law would reintroduce fiscal incentives. A review of the bill's outline indicates many similarities with the former CATs.

d. Information. Information services to the non-traditional export sector are discussed in two categories: services which are used and sources which are available but not used.

Services which are used. The only specific services which exporting firms use with any regularity for information related either to the production or commercialization of products appear to be private enterprise ones. Networks of brokers, distributors and agents, along with, in some cases, parent or partner company sources and, in most cases, personal networks developed over time seem to form the information base, which private non-traditional exporters use. The attendance of many exporters at workshops, seminars, and meetings organized by national (e.g., FOPEX and MICEI), regional (the Andean Pact's Export Promotion Program), and international agencies has served primarily as an additional forum in which these private networks have been developed. In Andean Pact countries, where market access difficulties have arisen because of public sector decisions in the member countries, and where the various heads of government and relevant ministers hold intergovernmental discussions with a view to improving trade, the private non-traditional export sector nonetheless relies upon its own networks for information.

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1/ CENDES, "La Producción Manufacturera . . . . .," p.33.

Services available but not used. In the national public sector there are a number of services made available to exporters:

- the Ministry of Foreign Affairs has commercial attaches in 22 countries. Exporters report occasionally receiving inquiries from potential buyers passed on by the attaches.
- the Ministry of Industry, Commerce, and Integration produced a publication listing Ecuador's non-traditional export products<sup>1/</sup> and reports that some 200 inquiries have been received in one year in response to its circulation and that 52 products were placed in foreign markets as a result. MICEI provides seminars on subjects related to international trade, and is a latent source of trade data, import regulations, preferential agreements, and international economic trends as it collects and stores such information on a regular basis.
- the Central Bank has a computerized information system which is another latent source not actively available to exporters. It also publishes collected statistics on Ecuador's exports.
- CENDES, the Centro de Desarrollo Industrial del Ecuador, carries out investment studies for potential industrial projects and reports success in that many of the studies have led to investments on the production side. It has a substantial technical library, is computer linked to international data banks, and puts out a monthly bulletin. It is a major intra-public sector source of information.
- CFN, in a somewhat similar but much more specialized and limited fashion than CENDES, and its FOPEX division are latent sources of information potentially available to exporting firms.

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1/ MICEI, Dirección General de Promoción de Exportaciones, "Oferta Exportable de Productos No Tradicionales del Ecuador", June 1982. MICEI also publishes since 1982 "Informativo Comercial," a somewhat periodic pamphlet on trade data. For instance, "Demanda Internacionales de Productos Tropicales," Marzo, 1982.

In the international public sector there are information systems or services available in Ecuador. These include:

- OAS, the Organization of American States, publishes from Bogotá a weekly bulletin of international market opportunities (supplies and demands) entitled "Red de Información Comercial". It lists Ecuador products and copies of it are available at the offices of the Cámara de Comercio.
- Pacto Andino publishes from Lima a monthly "La Oferta Exportable de los Países del Grupo Andino", which lists products available and products demanded. Ecuador's products are listed. Copies are available in the offices of MICEI.
- PNUD, the U.N.'s development program, has produced a study on the U.S. market requirements for Ecuador's non-traditional export products. It is available in the PNUD office in Quito.
- CCE, the Comunidad Económica Europea, has produced studies on European market requirements for Ecuador products (the "Metro studies") which are on file at MICEI.
- GTZ, the West German development cooperation agency has agreed to assist OCEPA (see, below, p. 36) in establishing an office in Frankfurt for supplying information on markets, for distributing and for storing artisanal exports.
- Quito based embassies, including the U.S., have commercial sections which could be a potential source of information for exporters.

In the private sector, aside from the services of FEDEXPOR and the commercial networks mentioned at the beginning of this section, there are no information services currently available to exporters. The Cámaras do receive a large number of publications and have telex connections and are latent sources available to an exporter.

e. Policy. Policy level decisions affecting the non-traditional export sector are spread over a number of institutions in the public sector. The most notable would be:

- fiscal, monetary, exchange, and financial policy responsibilities are shared amongst the Ministry of Finance, CONADE, the Monetary Board, and the Central Bank;
- sectoral policies, especially in the important primary and agro-industry sectors, are shared between the Ministries responsible for Agriculture and for Natural Resources;
- promotional policies are largely the responsibility of MICEI;
- international trade agreements are the responsibility of MICEI.

In law,<sup>1/</sup> MICEI has the responsibility to formulate external trade policy "in coordination with" the other relevant ministries and public sector bodies. In practice, MICEI has no significant role in the first two policy areas mentioned above, and thus, has no direct influence on the competitiveness of Ecuador's non-traditional exports.<sup>2/</sup>

The private sector principally through the activities of FEDEXPOR, has had a small but growing consultative role in all of the policy areas noted above. Under the proposed export promotion law this role would be strengthened.

f. Documentation. A familiar observation in Ecuador is that it has been easier to import than to export, and that exporting is a long series of visits to government offices. Interviews and reviews of the documentation process do not sustain the

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1/ El artículo No. 183 de la Ley Orgánica de Servicio Exterior, October, 1964.

2/ PNUD, "Comercialización .....", p. 9.

validity of this observation<sup>1/</sup> except for agricultural products. The export procedure is fairly straightforward, and the experienced firms report no difficulties. There are apparently difficulties with Central Bank procedures and the exchange rate system is not appealing to exporters, but the process does not appear to be a constraint in the narrow sense of a factor which reduces total exports.

While the documentation process is not itself overwhelming, when combined with the related process of achieving concessional credit and complying with foreign exchange control regulations, it can be a challenging prospect to firms which have not been exporters. In any effort to increase and diversify exports, a simplification of the process and a reduction in the number of offices to be visited, would be a prerequisite.

Another facet of the documentation process, and one not normally referred to, is that part of it is required by the laws and regulations of the importing countries, some, of which, again most strikingly in the case of the agricultural sector, insist upon substantial amounts of documentation. These can be constraints to small firms which cannot cover the overhead costs in terms of the time requires of qualified staff both in Ecuador and the importing country, attendant to meeting these requirements. The commercial attaches of Ecuador based overseas were not mentioned as being useful resources in this process.

g. Technical Assistance. Interviews and a literature review, including a review of the reports of relevant institutions in the public and private sectors, indicate that with the exception of assistance provided by MICEI for participation in international fairs and exhibitions, no source of technical assistance is available to exporting firms insofar

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<sup>1/</sup> See, Banco Central and MICEI, "Trámites para Exportar," p. 81.

as export commercialization is concerned. Assistance is available on the production side, especially from MICEI's Dirección Nacional de Asesoramiento Técnico al Sector Industrial (DINATI) and CENDES. DINATI is the major channel for external development aid technical assistance. The Instituto Ecuatoriano de Normalización (INEN), which is the national standards organization, provides an indirect production side technical assistance through its setting and monitoring of quality standards. The type of production side technical assistance which does not appear to be available is one addressing problems which arise with an attempt to enter a foreign market with a product developed under the import-substitution protectionist policy. A reported example would be instant coffee for international markets. Instant solubility is expected, while this is not the case for the domestic market. Other than through commercial trade channels, there is no specialized assistance being provided which can resolve this type of problem.

#### 7. Non-traditional export system weaknesses

The MICEI's 1980 survey referred to earlier, received responses from more than 400 firms on the problems which they confronted in exportation. According to this survey, the major problems, in order of the most pressing to the least, were: documentation process (cited by 38.6 percent of the firms), prices, market information, transport, and raw materials.

A different summary of the obstacles, or system weaknesses, drawing on interviews and more recent data is as follows:

training: there is an inadequate provision of services for training exporters on the commercialization of non-traditional products. This conclusion takes into account the courses and seminars sponsored by FOPEX, CENDES, international agencies and others.

service centralization: there is an inadequate centralization of the documentation process for exports, especially in that different steps occur physically, in different offices.

market studies: there are inadequate services for technical assistance to firms in the commercialization and, at times, production stages. The latter observation takes into account the services of DINATI, CENDES, and INEN.

commercialization: there are gaps in the system which, if filled, would improve export prospects for non-traditional products. These would include: the lack of political risk insurance, the lack of specialized export trading companies, and the lack of global trade agreements covering non-traditional products.

internal linkages: perhaps the major system weakness is the inadequate linkage between the private and public sector entities dealing with the exportation of non-traditional products.

### 8. Public - Private Relations within the Sector

Oswaldo Hurtado became President in May, 1981, after the death of President Roldos. He came into office with a reputation as not being pro-business, and one can read both in the 1980-1984 Plan (which he presented) and in his public statements subsequent to becoming President, a certain reluctance or hesitancy with regard to adopting an export-led strategy. The Plan's emphasis on Andean markets as its major external focus was essentially an extension of the basic import substitution model. In practice, the Hurtado government has taken steps to improve Ecuadorian exports (e.g., devaluation), has not taken steps which would have had a negative effect, and has worked closely with exporters.

At the same time, given the partisan nature of much of Ecuador's politics, the central position of Guayaquil business leaders in major opposition parties, and the importance of Guayaquil enterprises in the export sector, it is perhaps not surprising that public sector-private sector relations with regard to the export sector have been marked by a solid amount of confrontational rhetoric from both sides and inadequate collaboration.<sup>1/</sup> Nonetheless, one can point to areas of solid common public-private agreement on measures to be taken to strengthen the export sector and to an increasing amount of consultation at technical and professional, if not at political and leadership, levels. The rest of this section will concentrate on these more positive aspects.

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<sup>1/</sup> The daily press as well as the various issues of Weekly Analysis provide indications of the nature of these strained relations. Interviews with public and private leaders also support the observations made in this paragraph. With regard to the developing consensus, see the report of a seminar on the sector, CFN, Boletín Informativo, Nos. 79-81, pp. 5-9.

During 1980 and 1981, with the strengthening of FEDEXPOR as a specialized private organization and the increased interest of the government in the non-traditional export sector, there was a gradual increase in the activities in which the public and private sectors consulted and, at times, collaborated. The first national convention of industrialists (January, 1981) produced recommendations specifically addressing the needs of the non-traditional export sector which, in a number of instances such as the formulation of a law covering export promotion, increases in financing for FOPEX, the development of an export insurance program and an increase in export tax credits were either in support of measures in preparation by government or led to government actions. Under the direction of MICEI, the government in 1981 was studying ways to reduce the documentation difficulties and delays confronting exporters, and was consulting closely with the private sector, through FEDEXPOR, in this work. Under the Ministry of Finance a group working to prepare the establishment of an export corporation was similarly working closely with FEDEXPOR. The Ministry of Foreign Relations was meeting regularly with FEDEXPOR on the activities of commercial attaches. FEDEXPOR officials were also being involved in discussions on Andean Pact and ALADI<sup>1/</sup> issues in Quito and were being included in the organizing of official missions to meetings in other capitals. Ministers and the President held meetings with FEDEXPOR members on the private sector's needs and on the measures which government could take to facilitate exports.

This panorama of increasing public-private consultations may have peaked with the September 1981 appointment of FEDEXPOR's Executive Director as the sub-secretary of Integration within the MICEI. By 1982, with a growing list of items desired by the private sector representatives discussed with but not acted upon effectively by the government, a certain resignation on the part of the private sector machinery became apparent, and this remained the situation in 1983 and early 1984. These items included export insurance, the formulation of trading companies, the passing of an export promotion law, and closer consultation on monetary and exchange decisions. Indicative of the nature of the problem, the 1982 report of the joint public-private committee on red tape was accepted by the government. It had identified many procedural changes which could be made by administrative decisions, most

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1/ ALADI, founded in 1980 in Montevideo, comprises: Argentina, Brazil, Chile, Bolivia, Paraguay and Uruguay.

of which were in the Central Bank. None of the changes has been made on a full basis; some have been adopted by some of the branches of the Central Bank, with the result being a procedural situation yet more confusing because requirements, in practice now vary from one branch to another.

## 9. The Sector's Private Institutions

a. General. FEDEXPOR. the Federación Ecuatoriana de Exportadores, is the only specialized private sector institution operating within the non-traditional export system. The bulk of this section reports on FEDEXPOR. There are however, several other institutions or institutional ideas whose activities are or could be related to exports. Before proceeding to the discussion of FEDEXPOR, these other organizations are mentioned.

Cámara de Comercio and Cámara de Industrias. These are the private sector organizations to which, by law, businesses and industries with the exception of small businesses must affiliate. The Cámaras are organizations which represent and protect the interests of their members. In the export system, they are responsible for issuing certificates of origin for exports to ALADI and Andean Pact countries. Perhaps because of the legal requirement for businesses to pay their Cámara membership, the Cámaras are fairly well financed and do not contend with the resource mobilization constraint that most other private institutions in Ecuador confront.

The Cámaras have not been able to consult effectively with the government in formulating and implementing structural and institutional changes necessary to convert Ecuador's economic base into a more competitive, export-oriented one. This is the most notable because of the similarity in their broad perspectives as to what economic strategy is required. At the present, the Cámaras tend to be politicized in a partisan, anti-government sense.

The basic opposition of the Cámaras has been to any form of extension of the public sector into the "productive" sector of the economy, in other words, an opposition to increased "statism". The irony is that the very strength of the Cámaras derives, at least in part, from the requirement by the state that businesses must be members. Of the major Cámaras, those of

Guayaquil appear to be the most politicized, those of Cuenca less so, while those of Quito would rank somewhere in between. The Cámaras de Industrias appear to be more politicized than Cámaras de Comercio. One of the final round contenders in the 1984 Ecuador presidential election, León Febres Cordero, is the former head of the Guayas Cámara de Industrias.

The Cámaras carry out a full range of representational activities, from issuing press releases to threatening and, in a few instances, organizing empressarial lock-outs. In respect to exports, however, the Cámaras have not conceived any coherent program. They have been reacting to successive crises by proposing essentially short-term adjustments, normally in the monetary, exchange and fiscal policy areas. The Cámara de Comercio of Guayas in April-May, 1983, did initiate an export promotion assistance program on the initiative of one of its directors. It consists of using published information and a telex to attempt to locate buyers for Ecuadorean products for which the producers or brokers have requested such assistance. In the four months, June - September, 1983 and in spite of substantial publicity at the outset, less than ten of the Cámara's reported 8000 members inquired about the service, and no success was recorded in locating buyers. The availability of financial resources seems to have permitted the Cámara to mount the program without much attention to the need.

The Cámaras generally participate in or sponsor, on an ad hoc basis, seminars and meetings which at times are related to exports, but they are not viewed by their members, by other private institutions, or by the public sector as export-oriented institutions. They are viewed as organizations whose members are importers, industrialists engaged in import-substitution manufacturing and businessmen engaged in the domestic trading of imported and import substitution products.

CICE. The Comité de Información de Contacto Externo was mentioned in a 1981, Central Bank publication as one of the principal private sector organizations involved in national development. According to a wide number of second-hand reports (it was not possible to interview the principals) CICE organizes occasional discussion groups and dinners which focus on issues related to the external sector. It seems to have been an idea which has not received the acceptance or support envisioned.

ECOPIAR. This is the export promotion idea of the Cámara de Pequeñas Industrias de Pichincha (Quito). The promoter

of the idea, Carlos Ribadeneira Godoy, attended an Andean Pact meeting on the promotion of exports held in Medellin in February and March of 1983; he reports that ECOPIAR is a "project" which has yet to receive support.

CCIE. The Camara de Comercio Internacional del Ecuador, headed by Walter Spurrier, the editor of Weekly Analysis, is an affiliate member of the International Chamber of Commerce. The latter is an organization which attempts to represent private enterprise interests in the international arena (commenting on or advising on, for example, UN proposed changes in consumer laws). CCIE is a small group organized in 1976, which has been hoping to gain the support of the major private sector representative groups (the Camaras de Comercio and Industrias) for it to be designated as the "national committee" of Ecuador, a recognition which would lead to a full (not affiliated) link with the International Chamber. The CCIE provides a periodic listing of Ecuador laws and regulations which affect the external sector, but otherwise provides no service on a regular basis.

Producers associations. Producers of major and minor products, especially agricultural sector products, are grouped into associations. These vary in their effectiveness within their own production systems, but in relation to exports the conclusion would be that, aside from very occasional statements in respect of crises, none of the producers associations is directly involved. An example of the type of involvement registered is the current attempt by the Association of Shrimp Producers to allow them to be paid in dollars at the free market rate, a decision which would increase their income by some 30 percent in sucres.

CORFEX. This is the acronym of what was apparently the first (circa 1979) of a series of proposed ideas for institutions, all similar, none of which has yet come into existence, but which is again being proposed (name unknown) in the current draft bill for an export promotion law. The idea is for a one stop center for exporters where all the documentation required for exportation could be completed. It also would organize missions and fairs, set export credit policy and train the commercial attaches assigned to Ecuador's embassies. It would be financed by a portion (two percent) of the tax revenue generated by imports. Promoted by FEDEXPOR, the idea has been opposed by leaders of the Cámaras who have viewed it as a possible increase in 'statism'.

**FUNDEX.** The Fundación de Comercio Exterior an idea which has been promoted by the private sector. It would be a training center for exporters, commercial attaches and others and to be the initiator of studies related to the export sector. Financing would be provided half by the Central Bank and half by the private sector, the latter to be organized by FEDEXPOR. It would be governed by a board of directors drawn from the government and, mainly, the private sector.

**OCEPA.** La Organización Comercial Ecuatoriana de Productos Artesanales is a private organization which recently has participated in international fairs and hopes to establish a Frankfurt office. It has shops in Quito, Guayaquil and Cuenca it promotes the export of artisanal products, particularly tapistries and textiles. While not referred to by any of the private sector people interviewed, it would merit a close review were one to have a particular interest in the exportation of products by the small scale sector (see, also, ECOPIAR, above). It has worked with CENAPIA workshops on marketing, design and quality control.

b. **FEDEXPOR.**<sup>1/</sup> FEDEXPOR is a voluntary private organization established in 1976 to promote non-traditional exports from Ecuador. As of June 1983, it had 89 firms as members and was hoping to have 25 additional ones join during 1983. An estimated 50 percent to 70 percent of Ecuador's non-traditional exports are made by FEDEXPOR members. FEDEXPOR's leaders report that more than half of its members are Guayaquil based firms. It is governed by an elected board of directors headed by a president elected for a term of two years. The current president, in the second year of his term, is José Tamariz Crespo, of the Guayaquil Salcedo group.

FEDEXPOR had a 1983 planned expenditure budget of \$6,300,000, with the largest portion \$5.5 million spent by the Quito headquarters and the remainder by the branch office in Guayaquil. The planned budget, obviously small in relation to FEDEXPOR's mission, anticipated a deficit of \$700,000. The budget level has stagnated since 1980 partly as a result of the

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<sup>1/</sup> This description and analysis is based on separate interviews with FEDEXPOR's President, Executive Director, former Executive Director, and the Director of its Guayaquil office, on information supplied by FEDEXPOR, on interviews with six government officials involved in export promotion and on interviews with fifteen private business sector leaders in which, among other topics, views on FEDEXPOR were solicited.

gradual fall-off in non-traditional exports. Annual membership subscription quotas are linked to the value of the firm's exports in the previous year. The membership of FEDEXPOR, in relation to budget support, is fairly evenly distributed; in 1983 the 22 largest firms will pay 30 percent of the budget, with the estimated 92 others paying 70 percent.

The staff of FEDEXPOR is small; three professionals and four clerical and other assistants in Quito; one professional and two assistants in Guayaquil. It is directed by an Executive Director based in Quito. In 1980, after the end of a relatively good period for non-traditional exports, FEDEXPOR opened its Guayaquil office, started a periodic newsletter and began a program of collection of export data. Since that time the staff has not grown.

Functions. FEDEXPOR carries out a number of functions related to those described in the non-traditional export system:

Finance. FEDEXPOR served as the private sector member on the Comité Administrativo de la Ley de Abono Tributario until the program for the issuing of negotiable export tax credits was ended beginning in March, 1983. FEDEXPOR's participation in the committee seems to have had some impact in changing the orientation of the government members away from a fairly negative view of the private sector's interest in the CATs toward a more positive one. It reportedly helped to reduce the long delay and uncertainty surrounding the awarding of the CATs, and, in general, helped to consolidate, in both the public and private sectors, the notion of FEDEXPOR as a professional, technical group as opposed to a narrow interest group or politically oriented body.

With both FOPEX and the Banco Central, FEDEXPOR has assisted members, particularly the less experienced exporters, in securing export credits. FOPEX has relied on FEDEXPOR as the point from which the specialized needs of private sector exporters can be articulated. Although there is no legal requirement that a firm be a FEDEXPOR member to be awarded FOPEX credit or a Central Bank sui generis credit, in at least one instance a first-time exporter reported that he was required by FOPEX to join FEDEXPOR. A possible explanation of this may be that FOPEX staff may have suggested strongly that the exporter receive assistance in charting his way through the necessary documentation process.

FEDEXPOR's leaders claim that their 1981 representations, including the submission of a major paper on the "damage" being done by the fixed exchange rate system, were a major force which led government in early 1982 to begin taking the decisions which led to successive devaluations after a ten year period of no change. They report having proposed either a floating rate or system of automatic mini-adjustments; the decisions taken ultimately reflected the acceptance of both alternatives.

Information Services to Government. FEDEXPOR efforts in information have tended to concentrate on keeping government informed as to non-traditional export trends and impacts of government decisions on export firms. In this area its efforts have been extensive; for instance, for 1982, a partial list of FEDEXPOR's activities to inform government would include:

- it submitted letters and held repeated meetings with the Minister of Finance, the Minister of Industry Commerce and Integration, the heads of the Central Bank, the National Finance Corporation (CFN), and the Monetary Board, and with the President, on topics such as trade barrier problems with Colombia and Venezuela, on the details of proposed laws for export promotion and for export insurance, on the need for monetary and fiscal policy and procedural changes, and on the impact of specific government monetary and exchange decisions on member firms;
- it provided detailed analyses of the likely affects on the sector of governments sweeping economic decisions of 1982;
- it assisted government to prepare for and participate in Andean Pact and ALADI meetings on regional trade;
- it played a major role in informing government of the need for creating specialized export trading companies and for including new products in the list of those eligible for export tax credits;
- it sat as a member of the official committees dealing with export tax credits, with preparation of export related laws, and with advising on regional integration affairs; and,
- it contracted and made available to government a study on monetary policy, (this was the study which helped to convince the Monetary Board of the need for a devaluation).

Information Services to Members. To its members FEDEXPOR provides information, on request, on the application of special trade arrangements (e.g. Andean Pact, ALADI, General System of Preferences), on upcoming trade fairs and other events, on the internal process of documentation for exports and on the application of Ecuadorean laws and regulations, and, in a few reported instances, has carried out simple market studies. As a matter of course it supplies members with notices of new laws and regulations through issues of its somewhat periodic newsletter, Exportador Ecuatoriano. In a broad sense, FEDEXPOR, also provides its members, much as it does government itself, with information on the impact of government actions.

FEDEXPOR has in its internal discussions, raised the idea of improving information services to members through computerized data banks, participation in market studies and assistance in preparing promotional material on specific products for external markets. Budgets constraints have not permitted the development of these ideas.

FEDEXPOR's Institutional Linkages. With Government. As is apparent from reading the above description of FEDEXPOR's information activities it has managed to link itself in a variety of ways with government at technical and leadership levels. Key staff of FEDEXPOR have taken positions in the government in the past and current staff are considering offers of similar posts. FEDEXPOR staff members have been named to official missions to foreign countries. FEDEXPOR staff and members have been named to government commissions and committees. Without exception, government officials in interviews spoke positively of the contributions of FEDEXPOR.

In the proposed new law for exports, the government is proposing several measures which while reflecting the view of FEDEXPOR as a viable and useful institution, are intended to strengthen it substantially. These include giving FEDEXPOR the status of a "cámara", making membership in FEDEXPOR one of the options mandated by law open to a business of industry, qualifying FEDEXPOR as one of the electors to the two private sector positions on the Monetary Board and making FEDEXPOR membership obligatory for those wishing to use the preferential credit lines of FOPEX and sui generis. Aside from formalizing the role of FEDEXPOR as the recognized private sector institution in the export system, the proposed changes would have the probable effect of ensuring the organization a steadier and growing budgetary base.

FEDEXPOR's links with the Cámaras are not as easy to characterize. In interviews, private sector individuals associated with the Cámaras indicated either no knowledge of FEDEXPOR, a little knowledge (a vague response), a fair bit of knowledge or great deal of knowledge. Similarly, opinions of FEDEXPOR ranged from its being a small, inconsequential idea, to its being a political vehicle of some unnamed group, to its being a struggling and at times effective group. A qualified judgement would be that the Cámaras have been hesitant about being too receptive to FEDEXPOR (there are exceptions; in Quito their office is in the building of the Cámaras and they use a Cámara telex) partly for reasons of bureaucratic turf protection, and partly because FEDEXPOR has not been willing to align itself, as it has at times been solicited to do, with the public political statements and actions of the Camaras. The proposal, in the draft bill for the new law, to give FEDEXPOR the status of a "Cámara" is not likely to increase the receptivity of the existing Cámaras.

FEDEXPOR has become a standard stopping point for staff of international organizations, public and private. A review of its activities over the January, 1982 - March, 1983, period indicates that particularly in regional activities FEDEXPOR has extended and deepened its connections.

In Social and Political terms, FEDEXPOR is an organization of businessmen. It has not, however, attracted the attention of labor or government groups except those specifically engaged in exporting. It generally reflects a social responsibility approach to the role of business. Its members, most notably its directors and the ones with whom the organization is identified, generally take a "what works" approach to business, labor, and government relations. Its most strained links would appear at the moment, given its determination not to adopt a partisan stance, to be those with some of the business interests most strongly associated with the current election campaign. There is a tendency for the organization to have a Quito oriented image (which would appear to be a hold over from earlier days given that most of its membership is now reportedly from Guayas) and a 'small' exporters image (the latter is valid given that the traditional exporters of cacao, coffee and banana, are not, by definition, included).

FEDEXPOR has had difficulty in sustaining the interests of its members, some of whom are firms that seem to join several private sector organizations while not seeking or hoping to receive a direct service from them. It has a voluntary leadership which has dedicated time to the organization and a somewhat lagging membership. The larger member firms do not require any direct assistance, while the smaller ones probably require more assistance than FEDEXPOR is in a position to provide (e.g., with technical issue of quality control, packaging, purchasing contracts). Its members, nonetheless, even when not receiving direct services, have a regard for FEDEXPOR as a private organization which is playing a role (some would say a limited one others would credit it with substantial impact) in informing and influencing public sector decisions.

10. Private Sector Institutional Weaknesses in the Non-traditional Export System

The constraints to the effective functioning of the private sector institutions are financial, technical, informational, training and 'mobilizational'.

Financial. Up to now there has been no strong financial base for private institutions in this sector. This can be seen in the failure of what would appear to be possibly good ideas (CICE, EXOPIAR, CORFEX, FUNDEX) to get started, and in the continuing budgetary weakness of FEDEXPOR. The proposed law would be expected to help relieve this constraint to some extent, but at the cost of converting membership in FEDEXPOR from a purely voluntary one to one with a mandatory basis in law. Given that other major private institutions have had this statutory membership basis, FEDEXPOR has been at somewhat of a disadvantage.

Technical. No private sector institution has had the internal capacity to produce services of a high technical nature, either to firms or to government. And none has served as a consistent vehicle for the intermediation of such services. This has been due partly to the very youth of FEDEXPOR, but more so because of the practice of the significant providers of such assistance, such as the multilateral and bilateral international cooperation agencies, to channel assistance through public sector institutions.

Also, the larger export firms have well developed, often contractual or equity based, arrangements for technical assistance.

Informational. No private sector institution is presently in a position to provide private sector exporters with detailed, current data on markets and market-related factors (e.g., distribution systems, packaging requirements, health standards). There have been tentative and unsustainable attempts in this field, such as the current one of the Guayas Cámara de Comercio (noted earlier) and some of the activities of FEDEXPOR.

Training. There is no established capacity within the private sector to provide training in topics related to external trade. As part of a two year Lima based UNCTAD/GATT supported curriculum development project for the Andean region, the Center for International Business developed courses which are reportedly now being given at local universities in international business administration topics, and the FUNDEX concept for a training institution is now an active idea.

Mobilization. Without understating the impact of FEDEXPOR, no institution has been able to strongly mobilize the private sector to represent and promote its interests as exporters. This is perhaps attributable to the tendency to organize on a sectoral producer basis, but it would appear also to be a hold over from the 1970's conception of production being geared primarily to a limited, albeit growing, domestic market and for producers and commercial interests alike thus to adopt a zero sum game approach, in which internal struggle rather than collaboration was the role (the coffee industry, with its three way split amongst producers, processors and exporters would be a classic example).

## II. Recommendations for possible Mission Assistance Strategies

### A. Basic Approach

There has been an open discussion within Ecuador in recent years as to what policy and institutional changes are required to increase non-traditional exports. This discussion, which is on-going, has resulted in the drafting of the current bill for the new export law. It reflects a wide consensus on needed changes. Private sector representatives have been strong collaborators in the formulation of this bill.

In the context of this discussion and consensus, the suggested approach to the sector for the Mission, then, has two aspects. First, activities of the Mission should be linked to the detailed development of some of the proposed changes. These changes likely will continue to be sought regardless of whether this particular bill is passed into law. The strategy suggestions which are proposed below, then, are made in the context of their being pursued as part of this implementation of a larger series of changes. Second, actions taken by the Mission in this sector, whatever the specific programmatic content, should have as a key objective the strengthening of the private institutions in the sector. A consistent theme in the Mission's approach should be the incremental correction to the present structural distortion in resource control in the sector (i.e., non-traditional exports are made by the private sector while services to the sector are centered in the public sector).

B. Strategies to address system weaknesses

The non-traditional export system's weaknesses can be addressed, on the one hand, by internal, domestic activities, and on the other, by a combination of internal and external actions.

1. Internal

a. Training. Provide support for private individuals and groups who are or potentially could be involved in export trade. If this is pursued, the UNCTAD/GATT curriculum developed for the Andean group and now being implemented in local universities should be reviewed; also, the proposed training institution concept should be considered. Fields of training would vary widely, from engineering and technical specialities to international trade practices and agreements.

b. Service rationalization. Provide institutional development support to efforts to rationalize the export documentation process and the provision of public sector services to exporters. The focus should be on strengthening the capacity of the private sector to participate in the control and management of these government services. The bill for the proposed export law does provide for the establishment of a central point which possibly might evolve into a centralized service provider, and which thus would be a major reference point for developing this strategy.

c. Detailed studies. Provide support for implementing specific export studies which have, as their principal objective, the placing of specific products in external markets. To distinguish this strategy from the more normal practice of supporting "studies", they should be done on a collaborative basis, in which potential private sector exporters play an important part. Also, a possible device to be considered would be including the costs of a study in a subsequent FOPEX-type, credit should the study result in actual market entry and sales. (This is the approach being followed in the AID/CFN export project.)

## 2. External.

a. Technical assistance. Provide arrangements through which external technical assistance can be directed to firms in the sector. Firms have problems ranging from specific technical ones (e.g., inadequate solubility of instant coffee) to general ones such as export market packaging and health requirements. There are no reliably consistent sources of technical assistance now available, particularly in the post-production or commercialization aspects.

b. Trading companies.<sup>1/</sup> Provide assistance in the initiation of private firms which would be specialized in the commercial exportation of non-traditional products to U.S. markets. Smaller producer firms clearly need this assistance; larger Ecuador firms which have until recently not been strong in U.S. markets (e.g., specialized plywood) might use it once its capabilities were developed.

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<sup>1/</sup> Colombia's experience in successful export development, including the activities of the export promotion organization PROEXPO which has a Quito office, could be considered in this context. AID's Washington based Bureau of Private Enterprise is another source of information on this topic. Roger Moeller of that office is the source of the following documents now on file at the Mission; Richard Cooper, et. al., "Export Trading Companies and National Department in Lesser Developed Countries," March, 1983; a presentation by Lo Christy, to the President's Task Force on International Private Enterprise, September, 1983; Letitia Erler, "Export Trading Companies," September, 1982.

c. Export agreements. Provide assistance in seeking, formalizing and implementing sales contracts for non-traditional products in U.S. markets.<sup>1/</sup>

d. Export insurance. provide assistance in the implementation of an export insurance program. U.S. experience in both the public and private sectors has developed a body of expertise in this area which can be called upon. That the U.S.

market accepts the largest percentage of Ecuador's non-traditional exports-estimated at more than 60 percent in 1983 - makes this a particularly logical connection.

C. Strategies to address institutional weaknesses

Institutionally the main weakness of the system are the inadequate linkage between the exporters in the private sector and the policy makers and service providers in the public sector combined with the weaknesses of the private institutions themselves. The strategies recommended are, thus, those which serve to increase private sector involvement and those which directly strengthen private institutions in the sector.

1. Private sector involvement

a. Projects. Provide for active and perhaps controlling participation of private institutions and firms in projects dealing with the sector.<sup>2/</sup>

b. Policy. Consult with, inform and collaborate with private sector export institutions and firms with a view both

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1/ The Swedish model of developing global export contracts based on non-binding target figures and on extensive work in Sweden is a useful experience to consider. The current president of FEDEXPOR is knowledgeable in this regard having recently visited Sweden and having participated in the intialling of a Sweden-Ecuador agreement.

2/ In the current AID/CFN project for studies aimed at developing non-traditional agricultural and agro-industrial exports, FEDEXPOR and several of tis member agro-sector firms should be integrated into the studies from the initial design stage onwards. Given the good working relations which already exist between CFN and FOPEX and FEDEXPOR, this should present nothing more than a normal amount of technical and professional difficulty.

to influencing private sector policy and to assisting the private sector to influence public sector policy.

2. Specific Institution-strengthening efforts

a. FEDEXPOR. Assist FEDEXPOR to provide a range of information services to its member non-traditional exporting firms; to channel external technical assistance to these firms; to mobilize increased membership participation; to improve its links with other private sector institutions, especially the Cámaras and producers associations; and, to develop a capacity to recover service costs from firms on a user basis. The Central Bank has funds which it is reportedly willing to contribute to assisting FEDEXPOR in a number of those areas. Also, FEDEXPOR is currently participating in the emergency committee established in July, 1983 by the Minister of MICEX to deal with the export decline and this should help to ensure that what is done with FEDEXPOR is not an isolated initiative.

b. Others. Adopt a passive but open approach to other private sector initiatives in the sector, initiatives which presumably will be made once the Mission's interest becomes apparent.

D. Strategies for inter-donor collaboration

Development cooperation agencies have not been very active in Ecuador in this sector. Those which have been active recently or currently should be informed of the Mission's evolving sector strategies and possible points of collaboration identified. The most obvious activities, in the short term, would be to: review the Ultramar studies on U.S. markets with the UNDP; review the Metro studies on European markets with the EIC consultants involved and participate in the currently ongoing public sector institutional review being done by the same group; establish at least an informational link with the consultants carrying out the World Bank incentives and protection study.

## C. Sectoral Analysis Small Enterprise

### 1. Sector Definition

The small scale non-farm enterprise sector in Ecuador is normally discussed in terms of small businesses and industries and, on the other hand, artisans. Small businesses are sometimes subdivided into those who operate in a fixed site with employees and those who are mobile, usually independent street vendors. The precise definition of these groups is an issue of some debate in Ecuador<sup>1/</sup>. INEC, the National Institute of Statistics and Census, has used the number of employees and the gross value of production as criteria for distinguishing the small from the medium and larger size industrial units. "Small" in terms of employees, has ranged from 49 or less to 20 or less, while artisanal is four or less workers, including family whether or not they earn a formal wage or salary. The World Bank, in the 1982 appraisal of the small scale enterprise credit program through FOPINAR, defined "small" in terms of assets of less than S/12.0 million sucres, excluding land and buildings. It also saw the sector as divided into at least two sub-groups, formal firms having seven to 20 employees and "artisan workshops" having less than seven. The Law for the Development of Small Industry and Artisanary defines small in terms of assets in which machines are used to process materials into products and in which the value of fixed capital, not including land and buildings does not exceed a certain point.<sup>2/</sup> Artisans are those units in which manual labor is the major production element.

The major formal financial institutions for the small scale sector, the BNF (National Development Bank) and the CFN (National Finance Corporation), both define small in terms of fixed capital (maximums of S/10.0 million and S/12.0 million, respectively), not including land and buildings and not taking the nature of the business into account.

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1/ A good review is, CENAPIA, "Estudio Sobre la Pequeña Industria en el Ecuador," November, 1981.

2/ The point according to CONADE is now S/12.0 million, it was raised recently from the former S/5.0 million.

## 2. Sector Size and Economic Contribution<sup>1/</sup>

The manufacturing enterprise sector according to 1978 official statistics is composed of some 100,000 artisan workshops (four or fewer workers) and 1,700 factories. Of the latter, no more than 1,200 were small, that is having 20 or less employees. On the other hand, the Federation of Small Industries (FENAPI), reports 2,500 firms as members and 6,783 as registered by law. INSOTEC, a private consulting group, identified 880 in the three provinces of Pichincha, Azuay and Loja. Between 1970 and 1980, 2039 firms were registered under the law providing incentives for small industries. During the period mid-1982 to mid-1983, the last year for which figures are available, 90 new units were registered. The national census agency, INEC, reported that in 1980, 94 percent of the manufacturing sector production units had less than 10 employees and annual sales of less than \$200,000.

In terms of units, a reasonable approximation is that in Ecuador there are more than 3,000 small manufacturing units with five to 20 employees and at least 100,000 artisan workshops with four or fewer workers.

In terms of employment the artisanal group is the major source of employment in the manufacturing sector, providing an estimated 70 percent of 340,000 jobs. The small group accounts for an estimated 10 percent, while the "others"--the medium and larger firms --supply 20 percent of the jobs. The "small" group in employment and output is of relatively minor importance compared to the artisan group in terms of employment and to the medium and large group in terms of employment and output. The trend, however, has been for this "small" sector to be the fastest growing.

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1/ The figures presented in various reports are seldom in agreement. The major sources are: Luis Luna Osorio, Investigación sobre la situación de la Pequeña Industria en los Países Miembros del Acuerdo de Cartagena: Situación de la Pequeña Industria en el Ecuador, Quito: Escuela Empresarial Andina del Convenio "Andrés Bello", 1981. FENAPI, "Informe del Presidente", Quito, 1983; CENAPIA, "Estudio ...op.cit.;" CONADE-ILDIS, "Las Políticas de Fomento a la Artesanía en el Ecuador," Quito: Enero, 1983; World Bank, "Second Small Scale Enterprise Credit Project, Staff Appraisal Report, Ecuador," 1982; MICEI, "Informe de Labores," Quito, 1983.

In terms of output and contribution to GDP, the figures are perhaps even more problematical than those for units and employment. The national statistics rely on information from units which actually report (i.e. for tax or industrial census purposes); this is a weak information base. The World Bank staff estimates are that the artisanal sector contributes 20 percent of the value of manufacturing output (60 percent) is contributed by 200 large units employing more than 100 employees. A reasonable conclusion would be that approximately seven percent of the output is produced by the "small" group.

A group probably not as numerous as the 250,000 (estimate run as high as 300,000) artisans, but significant in terms of people supported, is that of itinerant vendors. In Quito, there were 30,000 vendors identified by the municipality in 1982.<sup>1/</sup> The number for the country in 1984 is on the order of 100,000, or, in other words, an equal number of units as those of the artisans.

The small scale manufacturing sector in a comparative sense contributes more efficiently to several aspects of Ecuador's development than do the larger scale units. Its cost structures are more dominated by the use of labor and national raw materials, its unit costs of creating a job are lower (the World Bank accepts the estimate that it requires about five times as much capital investment in Ecuador to create a job in larger scale industry than in the small scale sector), its units are less concentrated in Guayas and Pichincha, and it is the sector which is particularly oriented to producing goods and services for the mass market.

### 3. Sector development

The small scale and artisanal manufacturing sector has long been of interest and importance in Ecuador. Cloth and hats provided by the sector were for many years significant export products. In 1945 hats accounted for 23 percent of Ecuador's exports. As recently as the 1960's, it has been

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1/ See, Fundación Ecuatoriana de Desarrollo and AITEC, "Programa de Desarrollo de la Microempresa," Quito, 1984.

suggested that artisan production supplied 98 percent of the country's shoes, 26 percent of its wood products and the major part for the clothing and household articles markets.<sup>1/</sup>

In recent years actions which have directly affected the sector have shifted gradually from a guild-like concern with craft protection to a more industrial expansion and promotion approach. The initial law, la Ley de Defensa del Artesano, was introduced in the late 1940's and passed by the legislature in 1953. It provided, in addition to a guild-like protection through the registration of artisans, exemption from paying of certain taxes and meeting other financial requirements of government. It also provided for mandatory participation in the social security system. The major effect of this law seems to be to permit many artisans who own workshops and employ workers, as well as non-artisans who own or contract workshops, to not pay sales and income taxes and to be exempt from the application of many of the legal protections which in formal sector enterprises are provided to employees. The guild-like protection thus is in the form of a trade restriction with the taxes and other requirements being applied only to those who are not registered. Its trade restriction (or effective protection) effect is clear in that perhaps the majority of artisans have not been registered. The law does not provide for the improvement or expansion of the sector.<sup>2/</sup>

The more promotion oriented approach to the sector began with the 1965 passing of La Ley de Fomento de la Pequeña Industria y Artesanía. The objectives of this legislation have been developmental (create jobs, increase savings, replace imports, decentralize industrial development, and improve

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1/ Victor Tokman, "Distribución del Ingreso, Tecnología y Empleo" Santiago ILPES/CEPAL 1975, referred to in CONADE/ILDIS, "Las Políticas .....", op. cit.; see also, CONADE/ILDIS, "Artesanías y Políticas Estatales," Quito, 1983.

2/ Under this law, "artisans" are those largely manual skill based workers, or working owners who have no more than six workers or employees

income distribution) from the outset. It led in 1975, to the creation of one of the sector's major public sector institutions CENAPIA, the National Center for the Promotion of Small Industry and Artisanry, and led, in the 1970's, to a wide number of initiatives being taken by government to regulate and provide incentives to the sector: a system of categories according to scale was introduced; special guarantee and development funds and special credit lines, including one from AID for \$4.5 million dollars for capital investments were established; specialized government bureaus were opened to deal with the sector; special fiscal incentives for units locating in region other than Guayas, Pichincha and Galapagos were developed; industrial estates were opened; and, special government committees to coordinate inter-bureau activities were formed. Apparently only a small number of small scale enterprises apply for the benefits provided by the development arrested legislation, and it has been estimated by CONADE that the small scale sector receives only two percent of the fiscal incentives of the total fiscal benefits actually provided by the government.

The result of both the "defense" and the "promotion" laws, institutionally, aside from the growth of the public sector regulatory, promotion and analysis units, has been the growth and expansion of associations of artisans and small industry owners at municipal, provincial and national levels. The law provides that the small industrialist or artisan must be a member of the relevant association as a condition for receiving concessional credit and other assistance through the public sector. Another result has been the continued seeking by the associations of more benefits for their members. The unification of the two laws was proposed during the 1960's (AID supported the preparation of a draft, unified bill). This was not achieved, and the different interests of the different groups covered by the two laws make such a unification unlikely. Also, the smallest of the small, the vendors, have been mainly approached from a control (e.g., health regulations; commercial zoning) perspective.

The 1980-1984 national development plan emphasized that the development of small industry and artisan workshops was the "strategic element" in the national industry

development strategy, especially because of the importance of this sector to efforts to "decentralize" <sup>1/</sup> the national economy and solve the problems of unemployment and underemployment.

In the last two years, there appears to have been an intensification in the small industry efforts of the public sector organizations which have the responsibility or potential to assist the sector to make more effective their activities. SECAP, the large public sector vocational and skill training institution, has secured major multilateral and bilateral assistance (World Bank, Germany, U.K., Spain, Brazil) and at the same time has begun to develop programs especially directed at the needs of small industry. If successful, these will do much to improve the (currently low) regard for SECAP held by many of the sector's leaders. CENAPIA has moved to work more closely with the sector on technology development, particularly for small scale food processing. CENAPIA, the small industry arm of MICEI, was the only part of MICEI to receive a budget increase between 1980 and 1981. The CFN, in addition to its FOPINAR credit program, has entered into an agreement with INSOTEC, a non-profit group with a special interest in small industry development, and FENAPI, the national federation of small industry chambers, to assist the metal working sub-sector. CONACYT, the National Science and Technology Council has contributed to a technology development project with FENAPI and the Central Bank sponsored an agreement with Spain to promote, through a unit called PROECUADOR, joint ventures involving small scale industry. CONADE, the national planning agency, carried out a major-review of the sector and has prepared comprehensive recommendations for government action (this should be available in March, 1984).

Most "practical" actions over the past two years directed to the sector, however, have concentrated on providing greater (but still very limited) technical assistance in commercialization and production related areas; on the provision of industrial estates where services and utilities are provided; and on ensuring a flow of concessional credit. Thus the World Bank in 1982 approved a second small enterprise credit to CFN-FOPINAR of \$40.6 million dollars following a \$20.0 million dollar credit in 1980 and the Central Bank in late 1983 opened a guarantee fund of US\$0.6 million annually to

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1/ The decentralization objective was stressed anew in the Ministry of Industry, Commerce and Integration report to the Congress of mid-1983. See, MICEI, "Informe de Labores," 1982-1983, Quito, July, 1983.

cover up to 80 percent of the loans made by private banks to the sector for specified productive activities. Nonetheless, a negative development is the apparent falling off from late 1970's levels of credit to the sector provided by the financial system and particularly by the National Development Bank, but this appears to have been a problem more of poor administration than of policy.

With regard to the artisan group, as well as to the small commercial and service businesses, including vendors, the major positive developments in the past several years appear to have been a heightened awareness of their importance as a provider of large scale employment and of the need for more active and coherent strategies and programs to assist them. However, one does not see, as is the case with the small industry group, an actual intensification of efforts to assist these groups.

In 1983, as a response to the general decline in the Ecuador economy, an interinstitutional commission was formed, comprised of FENAPI, the Chamber of Small Industries of Pichincha, CENAPIA and the small industry and artisan promotion. The purpose of the commission is to examine ways to assist the small scale sector during what is expected to be several years of economic difficulties. The commission has provided for a group of studies to be carried out. Some are sub-sector analyses (e.g., metalworking, textiles, wood products) while others are more broad and indicate some of the strategies being considered (e.g., credit guarantees, imported inputs, credit unions for small scale establishments and group purchasing arrangements).

#### 4. Sector Trends

Major trends of the sector have been a continual growth in the number employed by the artisan group (JUNAPLA figures indicated a growth from 189,000 to 225,000 between 1966 and 1978), a continual decline in the proportion of manufacturing sector employed who are in the artisan group (from 84 percent in 1966 to 70 percent in 1979), and, according to World Bank reports, relatively fast growth in output, employment and productivity in the small industry group. By comparison, there has been only slow and, in the past several years, negative growth in the medium and large scale manufacturing sectors.

The rapid growth of cities in Ecuador , especially of secondary cities, is a broad social trend which creates the basic condition for much of the small scale sector expansion. The growing informal sector, particularly of small commercial and service establishments and of vendors, is a reaction to the increased need for marketed goods and services that has accompanied this urban growth as well as being the basic survival strategy of individuals in a situation in which the formal sector is contracting (negative or zero national macro-growth in 1982 and 1983 and very low growth, at best in 1984), in which there is not a developed "safety net" for the unemployed and in which, thus, the most common, viable alternative is to go into business, however small. The exceedingly rapid growth of artisan furniture workshops is most likely a direct reflection of this urbanization trend.

The small sector most likely has been less affected by the national economic decline than the medium and large groups. One can assume that the cost structure of small (as opposed to the artisan) group has been affected by the continued increases in nominal minimum wages, but these increases by law have been less for small units than for large ones (partially offsetting their higher proportion of labor costs to total cost). Also, the decline and particularly the external sector crisis and the demand and import restrictive measures taken by government to deal with it, may have worked to the relative advantage of the small sector. Their main dependence is on domestic inputs and that their main industrial sub-sector concentrations, in textiles and food products, are in areas in which market demand is comparatively resistant to macro level demand declines. The import restrictions however, have had some effect on the sector and the sector's associations in January and February of 1984 made representations to government to have them lifted.

##### 5. Comment/ Analysis on Sector Performance

The broad thrust of the public policies for the small scale sector over the past 20 years have been to contribute to its modernization and steady growth. The initial interest with craft defense, gradually evolved into an interest in the transformation of this group into a small and medium scale industrial group within the general policy framework of import substitution, industrial decentralization and job creation.

The growth of the sector, nonetheless, is due more to the macro growth in demand during the 1972-1982 period than government policies and public sector institutional efforts.

By all accounts, the number of artisans and small manufacturing units not registered under the law, and thus not eligible for benefits, is much larger than the number registered. Secondly, many of those registered are first time businesses as opposed to already operating artisan units. According to the policy intentions, the application of the policy regime was to offer the opportunity for artisan units to be modernized, yet 70 percent to 90 percent of the registered small industries in Ecuador have their origin in non-artisan backgrounds.

## 6. Components of Sector's System

### a. Finance

Credit to the small scale sector is provided mainly by private sector institutions. The results of a national survey in 1978 indicated that private commercial banks (67 percent) and private financieras (eight percent) provided 75 percent of the credit received by small enterprises. The BNF (National Development Bank), with 25 percent, was the largest single source. World Bank estimates were that total credit required by the small scale sector in 1982-1983, was on the order of US\$156 million. This represents about 20 percent of the total industry sector credit demand. About 17 percent of the small scale demand is intended to be met by FOPINAR, the CFN/World Bank program which channels funds through the private banking system.

Other sources of credit are suppliers, family and friends, and the informal sector. An ANDE study in 1979 indicated that suppliers' credit accounts for 28 percent of total credit to the sector. At the smallest often informal level, the relative importance of the different sources of finance are different from those of the more formal small sector. The results of a 1983 survey by AITEC in Quito were that were that the distribution of sources was suppliers (31 percent); family and friends (29 percent); private banks (27 percent); and private non-formal lenders (12 percent)

Monetary regulations require that private banks provide a certain portion (20 percent to 25 percent) of their total credit to the productive sector including small scale enterprises. It appears, however, that only about half of the credit provided by the formal private banking sector can be accounted for by this minimum and by the funds which the banks receive through the Central Banks' rediscounting of loans. The conclusion is that the private sector seeks small sector

clients in excess of the levels required (by the regulations) or promoted (by the fondos financieros discount mechanisms) by the public sector. Aggressive banks, for example the fast growing Banco Popular are reportedly interested in increasing their penetration into the small scale market.

An important trend to observe is the lack of any particular dynamism in the provision of credit to the small scale sector either by the national financial system (as reported periodically by the Central Bank) or by Ecuador's major public sector development banking institutions (BNF, CFN and the "fondos financieros" mechanism of the Central Bank). In real terms (constant 1975 prices), credit by the system to small industry reached its peak of 12.6 percent of total credit in 1978; in 1981, the last year prior to credit restriction being applied to contract the economy, it had fallen to 5.7 percent. In the public development banking sector small industry has not been able to increase its total share from its 1979 high of 16 percent (in 1981 it was 15 percent) in spite of the additional resources of the World Bank which were placed into the CFN for the specific purpose of assisting small industry. Fondos financieros now appears to be the principal source of credit to the sector. And while the amount provided through fondos financieros in current prices has steadily increased, the actual proportion provided to small industry has declined from a high of 30 percent in 1978 to 21 percent in 1981.<sup>1/</sup>

The geographic distribution of credit to the small scale sector by the public development banking sector appears in recent years to have gone disproportionately to the Sierra (principally Pichincha). According to official reports of the institutions, 60 percent of the funds from CFN's FOP INAR program in 1983 were invested in the Sierra as compared with 40 percent in the coastal provinces, half of which was in Guayas. A distribution of 56-44, Sierra-Costa, was reported for those National Development Bank funds which went to the small scale sector.

b. Technical Assistance and Training

Technical assistance to th's sector is the responsibility of two public sector institutions, CENAPIA and SECAP. Recently, FOPINAR has begun to provide technical

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<sup>1/</sup> See the discussion in Suma, January, 1984, and the Central Bank's Boletin-Anuario, 1983.

assistance as an element in its credit program. With CENAPIA and FOPINAR, the technical assistance is at an administrative or managerial level covering activities such as feasibility studies, training, promotion, and legal bureaucratic or credit process assistance. SECAP, while it recently has entered into agreements with FENAPI and with international donors which would result in a program components addressing the needs of the small scale sector, has dealt principally with meeting the accelerated training needs of medium and large scale industry for technically trained operators and supervisors. CENDES, the national center for industrial development, directs its activities mainly to the medium and larger scale sectors. CENDES does have a technology information center in Guayaquil which could be of use to the small scale sector. There is a coordinating committee for technical assistance (CCI) to the sector (composed of the director of FOPINAR, the president of FENAPI and a representative of CENAPIA) but unconfirmed reports are that it does not function with consistent authority.

INSOTEC, a private institution, and OCEPA, a "mixed" enterprise, make technical assistance available. The former works closely with FENAPI mainly on topics which address management and administrative needs. OCEPA, which in a sense is one of the sector's more known institutions (e.g. the president is one of the six directors of CENAPIA), is rarely mentioned by the small scale sector as a source of assistance. CENAPIA, partly with World Bank funds channeled through the CFN and approved by the CCT, provides accounting assistance and information assistance on credit lines, principally FOPINAR and fondos financieros, through short courses. CENAPIA reports that it provided, in the 1982-1983 fiscal year, on-site technical assistance to 610 artisan workshops, 557 of which were located in Guayaquil. It also reports on-site assistance to 48 small industries in areas, in addition of accounting and administration, such as fruit and vegetable processing, ceramic production and small scale sugar and alcohol production.

The official point for the coordination of international assistance to the industry sector is DINATI, the technical assistance coordination division of MICEI. FENAPI and its offices and membership at the province level are, however, the organizations through which most of the actual coordination occurs. Much of the assistance provided is help with meeting documentation and other requirements for securing credit and fiscal incentives.

CENAPIA directs its efforts primarily to small industry and urban based artisans. Its main approach is the giving of short courses which tend to be geared directly or indirectly (e.g., management and accounting) to the commercialization and marketing of products. It also provides commercialization assistance through the organizing of fairs and expositions and the setting up of demonstration workshops. The assistance provided to the artisan group by CENAPIA is oriented to the modernization of productive units, as opposed to the development of groups or the identification of strategies for more vertical integration which would be geared to reducing the number of levels of middlemen, a perennial (but not necessarily valid) complaint.

#### 7. System Weaknesses

Major constraints to the development of the small scale sector in Ecuador are credit availability, skills deficiencies at management and technical levels and the limited access of small firms to design, engineering, production and marketing assistance. In terms of the systems described in the previous section, the system weaknesses are those in the finance and technical assistance and related policy areas which result in the foregoing constraints not being satisfactorily addressed.

Finance. There appears to be a shortage of finance available to the small sector at each scale level, for short, medium and long terms. For the formal small industry and artisan groups, the lack particularly of long term credit was identified in 1982 by the World Bank as a major constraint. IBRD funds made available to CFN/FOPINAR in 1980 to address this constraint for the small (not the artisan) sector were committed and disbursed at twice the rate anticipated; two years after the credit's approval, funds were being disbursed to the small scale sector at the rate of US\$2 million per month. A CENAPI study in mid-1981, based on sources which included ANDE, INSOTEC and ILDIS, found that finance availability to the sector was a generalized constraint. At the smallest scale levels, the 1983 AITEC survey of micro-enterprises in Quito similarly demonstrated a financial constraint, especially short term credit.

This financial constraint merits several comments. First, the rapid growth of the number of establishments in Ecuador over the past ten years has obviously strained the

management and administrative capacity of the formal financial sector. This, combined with continually changing laws and regulations which affect, albeit with the intention of benefitting, the sector results in a difficult, time consuming documentation and application process for the small enterprise which attempts to secure credit through the formal banking sector. Secondly, there is an obvious competition between small and large units for credit, and an equally obvious large unit bias within the banking sector, because of presumed lower unit banking costs in larger loans to larger units. This may be part of the explanation for the fact that the decline in the share of credit nationally directed to the small scale sector occurred during a period of apparent intensive interest in and promotion of the sector. Thirdly, in none of the reports on the sector has failure or slowness to repay credit been identified as a problem.

Given the consistent findings of studies of the sector that the unit costs of job creation are lower and that import intensities of the production process are lower than at larger scale levels, there are good policy reasons for at least moderating this financial constraint. Suggestions that the constraint might be resolved by more centralization in the responsibility for credit to the sector are, however, in the view of the author, to be avoided. The institutional pluralism of the sector's financing is an advantage, not a weakness. What is needed is a simplification of application and appraisal procedures (elaborate processes distort the market in favor of larger firms; one of the reasons reported by private banks for using more of their own funds rather than the ostensibly lower cost Central Bank rediscounts is the slow and staff time intensive process of obtaining the latter), an improved policy environment on interest rates (increased savings will raise the gross availability of credit), a lower public deficit (to reduce competition for the funds between the public and the private sectors), and the development of low cost credit extension mechanisms which would be suitable replacements for the more traditional banking sector style (which has a formal sector bias) and the public sector's "desarrollista" style (which tends to load additional bureaucratic costs on to the credit mechanism).

Technical Assistance. An evaluation of technical assistance activities to the small scale industry sector was carried out in 1981 by the World Bank. This was followed by further examination in 1982 during the appraisal of the second FOPINAR credit. The conclusion of these investigations was that technical assistance "efforts are thin, scattered and generally uncoordinated."

The major review of small industry carried out in 1981 by Luis Luna Osorio found that "the grand majority of the country's small industries receive no technical assistance." The total number of professional and technical staff providing technical assistance is very small (in the range of 30 to 40 individuals) resulting in few actual visits to production units, visits when made last only several hours and result in only superficial reviews of technical accounting and similar problems. CENAPIA's three to five day artisan courses are criticized as being too short, not specific enough to the needs of individual artisan sub-groups, and rarely followed by visits by technicians to the actual workshop of the artisans. For the small firms, it is extremely difficult to secure market studies or to tap into reliable assistance for establishing or upgrading production and accounting systems, for planning sales strategies or for seeking information of any type.

In spite of an increased interest in the small scale sector in Ecuador, an interest promoted both by local leaders and by international, particularly European and multi-lateral institutions, there remains a lack of clear focus on the part of policy-makers in the public sector as to who and what the sector is. This contributes to weak diagnoses of the sector (data scarcity and non-compatibility is a basis of inadequate policy formulation) and accordingly weak program efforts. The legal framework provides no indication as to relative priorities and organizations which provide technical assistance are consequently left to make their own choices. The 1984 CONADE study (forthcoming) may help to moderate some of these problems.

The only firms that can receive public sector technical assistance are those registered under the law as either small industries or artisans. In fact it appears that several times as many individuals are engaged in the registration exercise as in providing technical assistance. With only a minority of firms registered, and with a tendency for these firms increasingly to be, in legal terms, decentralized units of large firms (done so as to gain the fiscal and other benefits of the laws promoting small industry while avoiding the legislation which regulates labor conditions in medium and larger industries) the extent of the outreach of technical assistance is limited and probably inconsequential.

The World Bank's strategy to improve technical assistance to the sector has been to develop a public sector unit within CFN's FOPINAR charged with coordinating and providing technical assistance. It is a strategy not

dissimilar to the proposal in AID's February 1984 agribusiness development project identification document for establishing a specialized agribusiness unit in the CFN. INSOTEC and the Peace Corps strategies are to strengthen the capacity of the chambers of small industrialists as institutions capable of coordinating and delivering technical assistance. A number of organizations have oriented their efforts to strengthen existing public sector capacities in the MICEI or in CENAPIA.

The artisan group is the group which is remarkable for both the high number of organizations and laws intended to help it and, on the other hand, the relative lack of effective assistance which it receives. The JNDA, the National Artisan Defense Commission, charged with registering artisans, has four inspectors to cover the entire country, and an application can often take more than a year to be considered. The Ministry of Labor, often in collaboration with the Ministry of Education, church groups, artisan associations and municipal authorities, provides training at the local level but the persons who complete the training, often in sewing related tasks, find the employment market limited. CENAPIA's program has been mentioned earlier. The programs of technical assistance of most of the groups reflect a lack of clarity as to whether they are attempting to preserve artisans and crafts or develop them into small industrialists with a wider skill range.

At the smallest end of the small scale, the vendors and micro-businesses, there are no technical assistance services. This may not, however, be the binding constraint. Access to credit rather than technical assistance is, according to informed observers and to the AITEC study, the major obstacle.

### 8. Public-private relations in the sector

The small sector's relations with the public sector are different from those of the larger private sector and their interests are often different from those of the more "established" firms. Within the small scale sector there are also, of course, quite wide variations in interests.

As a rule, the small sector, is less dependent on government benefits and incentives and in many instances not fully within the grasp of the tax system, and has had few relations with the public sector in a development promotion sense. This is beginning to change. The restrictions on

imports applied in mid-1983 to address the external sector crisis led in early 1984 to representations by small industry groups to have them removed because of the negative effects on their businesses. A fairly aggressive upper leadership in FENAIY has in recent years begun to interact frequently with public sector institutions to secure, what in synthesis could be termed, a rationalization and improvement of the services officially intended for the sector. Because of the government's role through the JNDA in the registration of artisans, a process open to subornation, arbitrariness and delay, public sector officials and private leaders are often in discussion, but normally from a regulatory control rather than a development perspective.

### 9. Private Institutions of the Sector

The growth of the public sector in Ecuador, made possible during the mid-1970's in particular by petroleum revenues, is reflected in the number of governmental institutions which deal with the small scale sector. Because of the public sector institutional proliferation which has resulted, before discussing the private sector institutions, public institutions on the national level and regional level which deal with the sector are mentioned:

CONADE, the national planning agency, is the entity responsible for planning government programs and policies for small enterprise and artisanry. A small staff of three is responsible for the small sector. It is a good vantage point and a source of useful comments) but not a "force" within the sector. It is expected that the forthcoming CONADE review of the sector will provide a comprehensive summary.

MICEI, the Ministry of Commerce, Industry and Integration, is responsible for executing, and directing governmental policies for industrial development and for providing technical assistance. Its units include:

- Dirección General de Fomento de la Pequeña Industria y la Artesanía (with a staff of 34 and a wide mandate, it is spread thin)
- Comité Interministerial de Fomento de la Pequeña Industria y la Artesanía
- Junta Nacional de Defensa a la Artesanía (JNDA)
- DINATI (Dirección Nacional de Asesoramiento Técnico al Sector Industrial); some of its on-going activities deal with the small sector.

Ministry of Finance and Public Credit, along with MICEI, administers fiscal benefits for those establishments covered by the law for the development of small industry and artisanry.

CENAPIA, the National Center for the Promotion of Small Industry and Artisanry is an independent part of MICEI which provides technical assistance and coordinates with other organizations for small industry and artisanry development. It has a good sized staff including a reported 70 technical specialists. In addition to the CENAPIA activities already covered, it is charged with the "supervision" of fondos financieros small enterprise loans.

Central Bank of Ecuador distributes credit principally through its rediscount mechanisms (fondos financieros) to public and private entities to benefit the small industry and artisanry sector.

CFN, the National Finance Corporation, has its FOPINAR section which supplies credit to the small scale sector through commercial banks and which most recently is developing a technical assistance capacity.

Banco Nacional de Fomento, the National Development Bank, channels credit to small enterprises for development and technical assistance. It has been the major single institutional source of credit.

Ministry of Labor executes the government's labor policies, establishes minimum salaries for workers and arbitrates labor conflicts. It also arbitrates in cases of appeals against non-registration decisions by the JNDA.

CENDES, the National Industry Development Center, is responsible for promoting industrial development and for studies on industrial projects which fall within the government's priorities. Since CENAPIA's creation, CENDES has dedicated its efforts to medium and large industry. CENDES was created in 1960 with AID assistance.

SECAP, Servicio Ecuatoriano de Capacitación Profesional, (Ecuadorian Service for Vocational Training), a large organization with a staff including 340 people with professional or technical qualifications, offers accelerated training courses to skilled industrial workers and operators. It has directed its major efforts to medium and large industry.

INEN, the National Standards Institute, a part of MICEI with offices in Quito and Guayaquil, is responsible for quality control within the industrial sector, throughout Ecuador.

Superintendent of Companies protects and controls small industries established as stockholding companies for the interests of stockholders and associates.

Regional Entities are responsible for developing economic activities in specific provinces or regions:

- CREA. (Centro de Reconversión Económica) for the provinces of Azuay, Cañar y Morona Santiago.
- CRM. (Centro de Rehabilitación de Manabí) for the province of Manabí.
- FREDEFSUR. promotes development in the provinces of Loja, El Oro and Zamora Chinchipe.

The major private sector institutions of the sector are the following:

FENAPI, the National Federation of Chambers of Small Industries of Ecuador, is a small (4 staff) Quito based organization which has 16 associate provincial chambers (Pichincha, Guayas, Cotopaxi, Manabí, Azuay, Chimborazo, Tungurahua, Imbabura, El Oro, Esmeraldas, Loja, Cañar, Zamora-Chinchipe, Carchi, Pastaza, Bolívar). It claims to have 6024 affiliated small industries. Its main objectives are, in addition to defending the members' interests (law reforms, etc.), to provide technical assistance and training and to facilitate the channeling of credit to the sector. FENAPI is represented in several of the public sector entities (MICEI, BNF, Ministry of Labor, SECAP) and in

the private sector with the council of Production Chambers and Associations. The associated cámaras of Pichincha and Guayas, are FENAPI's strongest members although it is not clear how supportive they are of FENAPI. FENAPI in recent years has worked closely with CFN and CENAPIA. FENAPI works with four technical educational institutions in Ecuador in providing short courses for small business people. is also the main organization through which Peace Corps assistance to the sector is channeled.

The relations between FENAPI and its member chambers vary with changes in leaderships (the heads, usually in office for one or two years, serve on a voluntary basis). Further investigation would be necessary to ascertain, particularly, the relations between the two large Cámaras (Guayas and Pichincha) with FENAPI, and most particularly that between the Cámara de Pequeños Industriales de Pichincha, with its more than 2,000 members, and FENAPI. In its most recent report of its own activities, in which there is no mention of FENAPI, the Cámara lists its many interventions with the public sector policy makers, made with a view to effecting changes which would benefit their members. These activities ranged from discussions of exchange policy, to price controls, to credit policies, to wage and other labor legislation to customs procedures and import policies. The Pichincha chamber, on its own, has taken the lead in major discussions with government and in promoting the export potential of Ecuador's small scale industry sector.

INSOTEC, a non-profit organization, which specializes in social science research and technical assistance to Ecuadorian organizations (Instituto de Investigaciones Socio-económicas y Tecnológicas) is closely linked to FENAPI as an advisor and as a trainer of its member associations. Its staff do socio-economic studies, human resources research and publish a monthly economic analysis supplement for the newspaper Hoy. INSOTEC, with FENAPI, has been attempting to promote direct small entrepreneur to small entrepreneur ties between Germany and Ecuador. INSOTEC began in 1979 with support from several local development speciality and a few small business people. In 1980, it began a program of assistance to small industry. INSOTEC

receives its funds from the Konrad Adenauer Foundation (West Germany). INSOTEC's collaboration with FENAPI is intended to include helping the Peace Corps volunteers assigned to FENAPI and its members. INSOTEC will also be collaborating with AID in the Washington funded small entrepreneur development research project. INSOTEC, in its work with the members of the Cámaras of FENAPI, reportedly was "organizational development" techniques.

OCEPA. Organización Comercial Ecuatoriana de Productos Artesanales, was created by government in 1964 as an entity to commercialize artisans' products both nationally and internationally. In 1975, it became a mixed-economy enterprise: 60.44 percent of the stocks went to the public sector (MICEI) and 39.55 percent went to the private sector. At present, there are 218 stockholders, 80 percent of which are artisans (stockholdings from S/500 to S/150,000 sucres).

OCEPA has exported goods (textiles, tapices, masapan figures, panama hats, baskets) since 1979. In 1983, reportedly due to world economic problems, exports went down, but internal sales went up. OCEPA has stores in Quito, Guayaquil and Cuenca.

Cámara Artesanal de Pichincha, was created in 1973 and represents an important small portion (1800 members approximately) of the sector, in the following areas: leather arts, textiles and clothing, building and construction materials, stone and marble work, graphic arts and metalwork. They accept artisans that produce, not that provide services, like barbers and beauticians. It functions under the Development Law for Small Industry and Artisanry and receive an annual contribution of S/300,000 sucres from MICEI, for office rent and clerical staff.

The Cámara's main objectives are : to form artisans' guilds, inform members of the laws' regulations and benefits and maintain links between artisans and development institutions. Most commonly, the Cámara provides advice concerning pertinent laws, benefits and paperwork for acquiring credit.

Banco del Pacífico. This is a private bank, and the only one in Ecuador with an specialized artisans' credit fund, which was created in 1977. Offices at the Bank which use this fund are in Quito, Guayaquil,

Cuenca, Ambato, Machala and Manta. Between 1977-83, S/20'000.000 sucres in loans were made to artisans for machinery and raw materials. The Bank also provides economic advice and seminars. In Quito, the Bank's artisan office has two inspectors and one project officer. The Bank have registered 440 artisans in Quito and 140 with current loans (S/6'500,000 sucres). It deals with artisans whether or not they are registered with JNDA. The Bank's small scale lending program has been characterized as too lengthy and complicated for the majority of the business people in the small and artisan sectors. This is, of course, also a criticism of the FOPINAR program. A review of the Banco del Pacifico program is contained in the "Problems Related to Microenterprise Assistance Programs" study done by Bruce Tippett and Cameron Smith for the World Bank.

FECOAC. (Federación Ecuatoriana de Cooperativas de Ahorro & Crédito), is an organization that groups together savings and loan coops in Ecuador and defends their interests. It was created in 1961 with funds from AID. At present, they receive funds from CIDA (Canada). FECOAC represents its members in legal and credit matters concerning coops. They also provide technical assistance for a fee. This organization is not economically stable.

The Peace Corps program in Ecuador has developed links with the small scale sector. At present, there are six volunteers working (total amount of volunteers in Ecuador is 270) on a small enterprise development program. The volunteers are distributed among the following institutions: one in FENAPI; one in the Chamber of Small Industries in Ibarra and one in the Chamber in Riobamba doing technical assistance and guild and trade union movements; one volunteer in FECOAC doing technical assistance in accounting systems and financial diagnosis; one volunteer in ICE (Instituto Cooperativo Ecuatoriano) providing technical assistance in financial management and accounting for this institution that does agro cooperative training; one volunteer in the Centro del Muchacho Trabajador, that provides technical assistance in their vocational training and industrial placement programs.

## D. Sector Analysis - Agribusiness/Agro-Industry

### 1. Sector Definition

Agribusiness as defined for this discussion includes enterprises which produce, process, and/or market crops, livestock, fishing and forestry products, or which manufacture or distribute farm supplies. Agro-industries are defined as enterprises that process raw materials into consumer goods or inputs for other industries.

The main focus of this profile is on agro-industries and on the systems and institutions of the agro-industry sector. However, because of the close linkage between commercially oriented farmers and the development of agro-industries, as well as their importance for food security and export development, agribusinesses engaged in primary production are also touched upon and the major institutions which concern them are mentioned.

Because of the scope and the inherent complexity of agribusiness systems, this profile has been prepared using two approaches. The first is that of an overview of the system and its major institutions. The second has been a case study of a selected sub-system (abacá) in detail, because of its intrinsic interest as a commercial agribusiness sub-sector, the lack of other studies on the Ecuador abacá system, and as a demonstration of the carrying out of a rapid examination of a system.

### 2. Sector size and economic contribution

Agricultural sector production in Ecuador in 1982 contributed 12 percent of GDP. Agro-industry represented by (a) food products, beverages and tobacco, (b) textiles and leather products, and (c) the wood and furniture industry, contributed 9 percent of GDP, accounting for 72 percent of total non-petroleum industrial production. The agricultural sector provides employment for 48 percent of the economically active population, and the agro-industry sector provides employment for additional 2 percent (17 percent of manufacturing sector employment).

Of the approximately 1,000 agro-industries in Ecuador, 30 percent are located in the province of Pichincha and 30 percent in Guayas. This apparently indicates that the proximity to markets and developed industrial infrastructure are more important location decision factors than closeness to raw material sources. There is a difference in the relative concentration of types of agro-industries in these two centers. Guayas is in order of major importance, principally engaged in beverages and food, while in Pichincha the major emphasis is in textiles and food.

Agro-industries in Ecuador produce a wide variety of products including leather goods, paper and paper products, wood products, processed foods and beverages, tobacco products, animal feeds and alcoholic beverages.

### 3. Sector Development

The agro-industry sector in Ecuador grew steadily over the 1970's. Agro-industry (volume output) in 1982 was dramatically higher than what it had been in 1970. The food and beverage production index was at 193 (taking 1970 as the base 100 year), the index for textiles was at 250, and for wood products at 320. This development occurred within an import substitution policy orientation which provided many advantages to industry sector investors generally. The major actions with regard to the sector are those which created this framework for growth, and then, in 1983-1984, the stabilization measures which tend to work against this protective framework and which contributed to a drop in agro-industry output in 1982 and 1983 (the el Niño current related climatic disturbances was an additional factor).

The initial industrial development law (1957), as subsequently amended is the framework of fiscal incentives. Amendments in the 1970's emphasized decentralization and greater use of local raw materials, both of which would seem to favor agro-industries. The law provides for the granting of benefits to an establishment depending on the developmental value of its industrial category. Agro-industries of a large

variety<sup>1/</sup> receive the large number of benefits<sup>2/</sup>

#### 4. Sector Trends

The agro-industry sector's relative contribution to Ecuador's economic performance has remained steady over a

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1/ For example in the 1982, those agro-industries on the "special list of MICEI (which issues a list each year) and thus eligible for very complete benefits and protection were:

1. Edible crude palm oil.
2. Sesame seed oil for human consumption.
3. Soybean milk.
4. Soybean oil and flour for human consumption.
5. High protein vegetable food products for human consumption..
6. Rice, potatoe, yuca and quinoa flours for baking bread.
7. Canned heart of palm for human consumption.
8. Industrial processing of coconut.
9. Essential juices and oils for human consumption and . dehydrated pulp for animals.
10. Canned cooked or semicooked vegetables and meats.
11. Canned goat meat and sausages.
12. Canned foods in general.
13. Pureed banana and other fruits.
14. Jellies and marmelades.
15. Proteins and enriched foods for human consumption.
16. Enriched fruit and vegetable juices or concentrates.
17. Canned fruit and fruit juices.
18. Banana and platain flour.
19. Powdered milk.
20. Pateurized milk and its deratives.
21. Baby food.

2/ Benefits include: exoneration of licenses, registration fees and taxes; exoneration of capital subscription and working capital taxes; exoneration of export taxes; exoneration of import duties; income tax deductions for reinvestment; exoneration of local and municipal fees and taxes; etc.

ten year period. It contributed 74.1 percent of industrial sector gross value added in 1972 and 72.3 percent, ten years later. Over the same 1972-1982 period industrial output as a portion of total output also remained fairly steady moving from 19.7 percent to 17.5 percent of GDP. Over a slightly larger period (1965-1981), while the contribution of industry trended upwards very slowly, the major change was in the composition of the output within the agro-industry sector.

Textiles and wood product sub-sectors have been more dynamic than food and beverages. In 1965, the relative distribution was food and beverages and tobacco, 72 percent; textiles, clothing and leather, 20 percent; and, wood and furniture, 8 percent. In 1981, the distribution was 60 percent, 30 percent, and 10 percent. A similar phenomenon occurred with regard to employment within the agro-industry sub-sector. Using 1970 and 1980 figures the relative contributions were, in 1970: food, beverages, and tobacco, 52 percent; textiles, clothing and leather, 38 percent; and wood and furniture, 10 percent; ten years later the contributions were 30 percent, 50 percent and 20 percent, respectively. The food and beverage subsectors, however, grew very rapidly in 1974-1978. Wood furniture production has been one of the most dynamic of the sub-sectors, growing at a 25 percent annual rate during the 1969-1980 period. This sub-sector is also of interest because of the great number of artisan workshops (86 percent of the total number of establishments) and the heavy concentration in Pichincha (46 percent of the total).

Exports of processed agricultural products rose from US\$25.5 million in 1972 to US\$256.1 million in 1981. This growth resulted largely from the development of agro-industries processing marine products and cocoa (liquor, butter, cakes, and powder) and to a lesser extent, coffee products. In these cases the amount of processing done is very limited and thus the actual industrial value added as a proportion of total value is relatively minor. As an import substitution sector, agro-industry is attractive and the foreign exchange savings generated by the sector are perhaps its major contribution. However, imports of agricultural origin for industry over the 1972-1982 period moved from US\$ 40.3 million to US\$ 211.2 million. The volume of production of the principal agro-industry inputs produced in Ecuador (cotton, tobacco, African palm oil, sugarcane) have not, with the exception of

African palm which increased tenfold over the 1971-1984 period, kept pace with industrial needs. Sugar now is an imported commodity and in 1983 Ecuador lost its sugar quota in the United States. In tobacco, the 1981 volume indice for the tobacco industry using 1970 as the base (100) year, was at 605; over the same period tobacco output had increased only 65 percent.

The stabilization measures of 1982-1984, because of their general orientation towards making Ecuador products more competitive domestically (through import restrictions) and internationally (through devaluation) combined with a increased policy level interest in the agro-related sector, tended to create an environment conducive to the expansion of the agro-industry sector. Initial indications are, however, that the response has not been strong. Partly, this is explicable in terms of climate (major production declines of 30 percent in the coastal areas were caused by heavy rains) partly in terms of the macro-level fall-off in demand as the government introduced restrictive policies to redress the linked external sector-fiscal sector deficits, and partly in terms of a lack of investor confidence generally (pending elections, currency uncertainties). These factors notwithstanding, the response has been constrained by weaknesses in the agro-industry's system and in its institutions.

##### 5. Comments/Analysis/Constraints

Agro-industry shares many of the weaknesses of the Ecuador industry sector generally. Its growth was stimulated by protectionist policies and by large increases in demand during the petroleum boom. It is now under strain as effective protection levels are gradually being reduced and as the former steady increases in demand have changed, for three consecutive years (1982, 1983, 1984), into negative per capita growth. The agro-industry sector, much as the industry sector as a whole, is dependent on imports for capital goods. It is also, however, surprisingly reliant on imported raw materials and remains a net importer even without taking into account capital goods imports. The food sub-sector, the major group within the agro-subsector, has a low (compared with other sectors) proportion of its gross product in labor payments (7 percent as compared with 29 percent, 20 percent, 29 percent and 25 percent for construction, agriculture, commerce, and textiles, respectively) and reflecting the nature of agro-industry but also the shallowness of much of this industrial processing of the sector, only 38 percent of the value of its products is added by the sector itself.

Agro-industry in Ecuador has suffered indirectly because of the tendency for agricultural sector policies to be income distribution oriented, as opposed to production oriented. This has resulted in supply inconsistencies and insufficiencies domestically and a reliance on imported, and in some cases, subsidized inputs. Industry sector policies, on the other hand, have not favored a comparative advantage based industrialization, and thus have probably been distortionary in that industrial investments which under perfect competition would have gone into agro-industry sub-sectors, have instead gone into assembly, chemicals, metals and other sub-sectors. The incentives have provided a bias in favor of high capital and high import intensities, and by effect, though not by intention, a bias against high labor and high domestic (e.g., agricultural raw material) intensities which would be more in line with Ecuador's endowments.

Constraints to agro-industry development in Ecuador have been examined by AID over the first half of 1984, in the preparation of a agribusiness development project. Constraints which were identified are: i) credit, ii) technical assistance, iii) documentation and iv) policy.

i) Credit:

Investment capital is a critical financial constraint in the agro-industrial sector. The estimated demand for industrial investment (including agro-industry) to be financed between 1984 and 1986 is around \$660 million. The IDB considers that approximately 60 percent (\$390 million) of this amount would be required by agro-industrial and export enterprises over the next three years. The IBRD and the IDB last year provided loans to be channelled to private sector industrial investment of \$59 million and \$35 million respectively through Central Bank rediscounting mechanisms. The loans include financing of foreign exchange costs for agro-industrial projects.

In the agricultural sector most credit available is short term production credit. The development of agribusinesses based on permanent crop production or on-farm infrastructure investment which requires long term credit is difficult. Currently, the only source of long-term credit for agricultural production investment is an IDB credit line of \$3.6 million.

Additional resources to cover financing needs of new or expanded agribusinesses consist of domestic credit, supplier credits and guarantee operations with foreign banks through national banks and finance corporations. The combined IBRD and IDB resources amounting to \$94 million, are currently the only long-term resources available to the sector. Counterpart financing mechanisms provide short term credit particularly for export production (FOPEX), but generally do not provide funds on terms exceeding two years. Therefore, a large gap for financing agro-industrial investments will remain over the next several years. A key bottleneck to the mobilization of the IDB and IBRD funds will be the long term financing of local costs for agro-industrial investments.

There is no specific line of credit within the financial system available to the private sector for pre-investment studies. The Fondo Nacional de Preinversión (FONAPRE) is a pre-investment fund for the feasibility study of projects considered by CONADE as national priorities. During 1980-82, FONAPRE lent \$20 million for pre-investment studies, almost exclusively to utility companies, state enterprises and municipalities for public sector investment studies. The IBRD and IDB loans for industrial finance do not include funds for pre-investment studies. The lack of funds for such studies has limited private agribusiness investments.

ii) Technical Assistance:

Technical expertise in agribusiness technology, marketing and management are generally unavailable within Ecuador. Private sector firms considering plant modernization, requiring quality control improvements in order to enter foreign markets, requiring improvements in marketing and managerial systems, trouble shooting, etc., need foreign exchange and institutional support to finance and locate appropriate short term technical assistance. While technical assistance is generally provided through multilateral or bilateral agencies to public sector institutions, there is no established vehicle by which private sector firms can obtain the technical and managerial assistance which is periodically required.

**iii) Coordination of Documentation:**

The documentation process required to export an unprocessed or processed agricultural product or to establish a new agro-industry requires a pilgrimage through numerous public agencies. New exporters of agricultural products have lost export opportunities and occasionally their perishable products because of lack of coordination between public agencies in processing export licenses. There is no centralization of the document process for establishing agro-industries, and the procedures frequently require up to one year to complete due to the lack of coordination and red tape.

**iv) Policy:**

As discussed earlier, Ecuador's industrial incentives have tended to work against endowment and comparative advantage based industries, notably agro-industries. To create conditions for the development of a more efficient industrial sector, the government has drafted a revision to the industrial development law. The proposed improvements are somewhat marginal and reforms particularly in the area of trade policy will still be needed to stimulate greater use of manpower in the sector and to spur agro-industrial exports. At the government's request, the World Bank has provided financial and technical support for a study of industrial protection /incentives, to be undertaken with the help of highly qualified U.S. consultants. This study, which is to be completed by August, 1984, is expected to provide the data and analytical basis for an important restructuring of government policy in support of a more dynamic, competitive and outward oriented industrial sector.

**6. Case Study Abacá****1. Background**

Abacá is a banana-like plant grown commercially as a rainfed monoculture for the hard fiber which is extracted from its stalks. Several unusual properties of the abacá fiber (molecular structure, tensile strength, non-absorptive, stronger when wet) have contributed to its specialized application in the paper and to a lesser extent cordage

industries. It is the highest priced of the hard vegetable fibers. Ecuador and the Philippines are the two major abacá exporting countries with Ecuador producing 20 percent internationally traded abacá fiber. C.H. Dexter Corporation of Windsor Locks, Conn., purchases 40 percent of world abacá fiber including some 70 percent of Ecuador's exports. The U.S. market as a whole has been purchasing 80 percent to 90 percent of Ecuadorean abacá exports which normally total about 9,000 to 10,000 tons per year. In 1982, a low year, the abacá sector earned US\$8.8 million <sup>1/</sup> in foreign exchange from the export of 8,700 tons <sup>2/</sup>. With the exception of less than half a ton of first twist yarn from Cordelería Nacional S.A., a Guayaquil based firm, and the small scale preparation of ropes with which the bales are tied in preparation for shipment, processing is limited to classification and baling and all exports are of simple dry fiber.

Abacá production, processing and exporting in Ecuador is totally in the private sector. It is an export commodity in which Ecuador has a demonstrated comparative advantage, based largely on high quality fiber and on optimal growing conditions being defined in terms of distance from the equator (within 600 miles), altitude (1,000-2,000 ft.) evenly spaced annual rainfall (30" to 60"), volcanic soils, and adequate sunlight. It is a labor intensive crop with labor estimated to be as much as 50 percent of production costs.

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1/ This is the figure compiled from Ecuador trade data by Adminconsult. Data compiled by Dexter shows a US\$9.5 m total.

2/ The U.S. Embassy, Agricultural Attaché reported a total Ecuador production in 1982 of 11,000 tons (see report EC3006, 1983).

## 11. System Components

Land Supply and Production Unit Sizes: Abacá is produced on privately owned land located within 100 km of Santo Domingo. There are three large firms which produce abacá on a total of 3,000 hectares plus one large and one small marketing cooperative whose members produce on a total of 9,000 hectares. The single largest exporter, Cooperativa Abacá Ecuador, has 130 to 170 members whose fields range from 20 to 150 hectares with a reported mean of 35 to 40 hectares. The legal and institutional framework for private land ownership has generally served to protect the interests of the owners. One fairly major attempt at an "invasion", while eventually set back through legal channels, did however contribute to the owners subsequent decision to sell out. Land supply does not appear to be a constraint. Suitable lands are readily available. In fact, it has been suggested that as much as 4,000 hectares has been taken out of abacá production in the past seven years. While this figure is difficult to verify, one of the major producing firms reports removing 250 hectares of a total of 1,000 hectares. The alternative crop usually adopted is African palm.

Labor Supply: Basic labor (an estimated 2,800 field workers) in the abacá system is paid on a piece-rate basis. While it appears to be lowly remunerated, it is on a par with agricultural wage rates in Ecuador. The owners of the farms in some cases supply food and lodging as well. The labor supply is reportedly adequate, often from the coastal areas of Esmeraldas and, more predominantly, from Manabí, Riobamba and drought affected Loja. Labor is not unionized. Attempts to form unions have been unsuccessful in good measure because of legal obstacles (see the following "management" section). The legal framework for labor supply is the minimum wage (although it is open to interpretation in the piece-rate environment) and the guarantee, backed by law, that the worker be paid for work performed.

Input Supply: The use of purchased inputs varies widely among the producer units. Government, in the 1976-78 period under its banana program, had promoted the application to abacá of certain agro-chemical practices which had been shown to be economic in banana cultivation. Abacá producers after

following some of the practices were not convinced of their value. Those inputs which are used to some extent by some producers --fertilizers, nemacides, herbicides, insecticides-- are purchased from 8 to 10 private suppliers. The Centro Agrícola does not play a role in input supply. A corn weevil is reportedly the most serious problem which is addressed by purchased inputs. Input supply is constrained in Ecuador by limited knowledge as to the effectiveness, and as to the economies of the application of various inputs in crop production and protection operations.

Equipment, Machinery: The abacá industry in Ecuador uses simple technologies. These extend from machetes and mules in the field to 6hp to 7hp English and Brazilian gasoline and diesel engines to drive locally made spindle machines for fiber stripping. The cords for binding the bales are made, in one case, by a small engine driven weaving machine and in the other by a hand powered weaving machine. Machinery improvements would seem to be feasible at all of these stages. In addition, there is the potential for mechanization of selected field activities.

Technical Information: Research and Development/Production  
There is no public sector institution in Ecuador engaged in field trials or other investigations into the production or processing of abacá. INIAP (Instituto Nacional de Investigaciones Agropecuarias) is the parastatal agency which might be expected to be engaged in the abacá sector. It operates a major research station in the abacá producing area whose activities are focused on cacao, African palm, coffee and livestock. MAG (Ministerio de Agricultura y Ganadería) operates a banana extension program but this does not cover abacá. Furukawa, one of the private abacá producing companies has been furnishing seven hectares for a series of production experiments being conducted by persons contracted by Dexter. Dexter also is paying for the other costs involved. These experiments have at least 18 months to run. No information is available to indicate the prospects of useful results being achieved. The experiments are addressing issues of row spacing, density, optimum harvest time and fertilizer application with several varieties of abacá.

C.H. Dexter had, in the past, a research and development capacity which addressed abacá production issues. There are reports, for instance, of a Dexter agronomist attending FAO/UNCTAD meetings in 1979 with hard fibers, including abacá. The following, which is an excerpt from an annex to the FAO's 1979 "Report on the Technical Consultation on Abacá and Coir",<sup>1/</sup> suggests major areas in which research and development is required:

- Weed control which is presently done by slashing with a machete. This is a very labor-intensive and costly process. Grass weeds are also known as a primary host to vectors of virus diseases.
- Fertilization in abacá is rarely practiced. There exists very little knowledge of which fertilizers are needed for abacá in different producing areas. No reliable data exist as to what amount of fertilizer could be applied at different unit prices while still producing acceptable returns to the producer when he sells his fiber at a given price.
- The practice of shading is as old as the abacá industry, but only lately have its effects become better known. Shaded and non-shaded abacá plants in
- Philippines have exhibited different physical and morphological properties. Shading modifies the properties of the fiber, i.e. the strand tensile strength is reduced, the lumen is widened and the unit fiber length is increased.
- In Ecuador and the Philippines, harvesting is done when the stalk has borne the fruit. Researchers have found, however, that the best yields and quality of fiber are obtained when abacá is harvested just before the time of the appearance of the flagleaf. The delaying of harvest can cause brittleness and reduced tensile strength of fibers. Since fruiting is nutrient exhaustive, any delay in harvesting also means competition for solid nutrients and subsequently a delay in the production of leaves on other stalks. Furthermore, this delay

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1/ FAO, "Report of the Technical Consultation on Abacá and Coir", Rome, October, 1979. The report identification number is CCS: HB/TG 79/2 Part B (Abacá).

in harvest can also mean a loss of outer leafsheaths due to drying during this period. There may thus be considerable merit in harvesting stalks before the flagleaf stage provided that these have attained acceptable stalk sizes for good yields.

- Desuckering is in practice in some areas and not in others. There has been some indication that this practice is beneficial to the plant. There has been no long-term controlled study of this practice or of its economical effects.
- Some very recent studies have indicated that it might be possible to plant abacá like sugar-cane (ratooning). If this could be possible, the planting and harvesting might be mechanized.

Technical Information: Extension: The abacá producers report that there is no institution which provides them with technical advice and guidance. Farming methods are reported to have changed little over the years. The president of one of the abacá producing companies is a close observer of the effects of different practices and his observations along with those of some of the cooperative members are perhaps the major sources of knowledge.

Technical Information: Research and Development/Products  
A potential strategy for the Ecuador abacá industry is the diversification of the product market for the fiber as well as the development of varieties with different characteristics. This would entail the identification of new uses for the fiber thus widening the market in terms of volume and buyers. At the moment, there is apparently no institution engaged in abacá product development as such, although Dexter's research interests in innovative specialty papers may lead to new uses for abacá fiber. The following, an additional excerpt from the FAO report referred to above, suggests some of the areas in which investigations into diversified uses for abacá might be warranted.

Explore abacá pulps of various kinds, including those made from whole stalks and from de-fibering waste for traditional paper-making in tropical areas. The blending of abacá pulp as substitute for imported softwood pulps with native hardwood pulps for manufacture of packaging board, should also be studied.

Explore high quality abacá pulp for dissolving pulp applications, specifically for rayon. With the shortage of hydrocarbons, non-oil based fibers may become economically important again.

The development of a domestic bag industry for abacá, possibly mixed with other fibers, for use in agriculture.

The use of abacá in composite structures. This might be similar to the work that had been done with sisal in concrete or used with resins as binder in place of fiber glass.

Develop possible uses of abacá fiber for the textile industry, specifically for stiff woven material.

A closing observation on this question of product development: in spite of vast sums having been spent by many companies on the search for synthetic fibers, the special properties of abacá (e.g., it is non-harmful in sausage linings and cigarette filters) have not been totally duplicated.

Credit: There is no development credit available in Ecuador for abacá production. This is a result of the financial sector's view that the market potential for new supplies of abacá is non-existent. Short-term commercial credit, including overdrafts, are available for fiber purchases and storage at the warehouse level and for equipment purchase. Over the 1972-1976 period the Banco Nacional de Fomento had provided five year credits, with two year's grace, at nine percent interest for abacá development. S/500.000 (S/18 per US \$1) was the amount extended per 50 hectares. A number of borrowers (number unknown, but not insignificant) were unable to repay their loans and the result has been fore-closure sales. The producers' explanation for the credit repayment problem is in terms of the abacá market's demand and price levels, which historically, especially in terms of price have been erratic.

Transportation: The abacá stalks are transported from the fields to feeder roads by mules (sometimes by hand or by tractors), on the feeder roads to the defibering and drying location by mules, tractors and vans, and to the storage location by vans. From the storage points the baled fiber is

moved over road in 10 to 14 ton trucks, usually those owned by one of three transportation cooperativas (consortiums of private owners), 600 km to the port of Guayaquil. From Guayaquil all the Dexter purchases are shipped break-bulk on a Chilean line to New London; other orders are shipped either break-bulk or in containers. Dexter guarantees a load of 500 tons per ship call, thus ensuring the New London delivery. Dexter takes ownership in Guayaquil.

Management: The basic management system in the Ecuador abacá industry is the same for the large firms and the smaller ones. The owner, who not uncommonly is not resident, hires an administrator on a salaried basis to operate and to live on the farm. The administrator hires contractors on a fixed price basis to carry out the main harvesting to delivery operations. The contractor in turn hires piece work labor to carry out the specialized tasks. Additional operation, such as road maintenance, cleaning and fertilizer and insecticide applications, are paid on a day or hectare basis. In the smallest farms the level of administrator is not always present. In the largest ones an additional foreman level may be added. Off farm management, at the warehouses, is organized in a similar way. With the exception of the paying function, the CAE marketing cooperativa employs the contractor system fully at this stage as well; the larger companies have salaried staff in the key clerical and warehouse manager positions. The cooperativas and the firms maintain small (three to four people) central staffs--manager and assistants-- to organize and record the entire process from the fields to the ships.

The management system appears lean and to the point. In the case of CAE it is not very technified and this is reflected in the less technified (i.e., fewer inputs, fewer farming practice changes, lower fiber yields per stalk, more "problems" with fiber grading) appearance of its operation. It should be pointed out that no conclusion is being drawn as to the economic or financial effects of the difference in degrees of technification. There are no immediately obvious economies of scale achieved by the larger units.

The organizational structure specifically avoids the possibility of unions. The workers can not organize against the owner as they are not working for him, and, the unit sizes--the contractor's group--are below the minimum legal size required for collective bargaining.

Drying and Storage: Once the broad fiber strips have been removed from the stock in the field, defibering must occur in the same day. If not, yellowing and hardening (a problem for the extracting machines) set in. The drying, which in Ecuador requires a day in the sun, can occur more gradually, conditions permitting. Drying in Ecuador is a problem; the exported fiber often has a 12 percent moisture content. Dexter discounts the final price after measuring the moisture level. Movement from the drying racks to the storage points takes place frequently with the warehouses receiving on a five to six day per week basis. The storage of the fiber takes place at one of an estimated 15 warehouses, the ownership of which is spread over the major exporters and the small non-exporting Agro-fiber Cooperativa. Total storage capacity in all the warehouses is an estimated 5,000 tons. At the warehouse, the loose fiber is graded, weighed, baled (sometimes under pressure), labeled and stacked in preparation for shipment. Storage at the port is not normally for more than one day as shipments are only made on the basis of the confirmed arrival of the specific ship.

Processing: Processing is limited to the making of the rope with which the abacá bales are bound (at the rate of one kg of rope per export bale of 70 kg). The two artisans or small businesses in Santo Domingo who do this rope-making use simple technologies. One, a family operation which has been going for some ten years<sup>1/</sup>, receives refuse or tow grade fiber from the various warehouses and returns woven cords to them. They are paid, as they say, for their labor. The other<sup>2/</sup> uses a self-invented machine driven by a small engine to make a tighter cord. The owner, who sometimes has one employee, purchases refuse or tow grade fiber and sells cords, almost exclusively to the abacá warehouses. He reports having received a request from the banana box manufacturing firm for a

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1/ Located next to a furniture factory at 5 1/2 km outside of Santo Domingo on via Quevedo.

2/ Alfonso Sango, located on the Santo Domingo by-pass between via Quevedo and via Chone opposite the office of "Modelo Santo Domingo".

large order of cords which were to have been used to bind the flattened banana boxes prior to shipment from the factory. He did not accept the order because of the large quantity involved. He also reports that attempts by several artisans to make abacá floor coverings for local sale were unsuccessful because of the low prices received.

Cordelería Nacional (Guayaquil), a cordage and bag making firm, exports from 4 percent to 14 percent of total Ecuador abacá exports, with 1982 being at the very bottom of the range. All its exports are apparently in the form of first twist yarn. This firm is reported to have had the capability several years ago of manufacturing a full range of yarns and manila rope. Since then there have been ownership and management changes.

External processors, primarily Dexter, convert the fiber into paper and other products used for such end-products as tea bags, surgical applications, anti-static coverings, meat casings, oil filters, insulation paper for telephone cables, cigarette and other filters, currency paper, etc. Cordage plants in the U.S. and other countries import abacá fiber that has been converted into a twine or yarn in the abacá growing area. Their products are numerous sizes and kinds of cords or ropes; a classic use of abacá has been for yacht deckings.

Markets and Market Information: The world market in abacá is led by Dexter Corporation, a specialty manufacturing firm and the purchaser of some 40 percent of internationally traded abacá fiber. Dexter has a contract with the major Ecuadorean exporter, Cooperativa Abacá Ecuador (CAE), to purchase a minimum of 4,200 tons (35,000 fardos) annually, up to a maximum of 4,800 tons. CAE can sell any excess on the world market, which in practice has meant that CAE has shipped exclusively to Dexter. Other exporters sell both under long term and spot contracts with information coming via telex from two brokers, Hanson and Orth, and Wigglesworth and Co. Ltd., one in New York and the other in London plus two Japanese brokers. Dexter's contract with CAE, which would seem to be the major market factor for Ecuador exports, allows Dexter to set the price, on a quarterly basis, and the grade desired, at

the time of its placement of each specific shipment order (some 10 a year to CAE)<sup>1/</sup>

Market information in Ecuador is thus dependent on a very few sources. Ecuador producers are price takers. A somewhat spectacular price rise in 1975 to \$0.75 per pound in the Philippines, a result of market supply/demand concerns following the selling off to paper and cordage manufacturers of the U.S. official abacá stockpile, in turn has given rise to rumors or questions in Ecuador over Dexter's motives in its market interventions. For instance, it is believed by some that Dexter attempted through disinformation in the late 1970's to stimulate production so as to lower the price; another explanation is that Dexter went too far in attempting to ensure an adequate supply level. The situation is one in which market information is both good (in the sense that people know what Dexter wants and, later, will pay) and poor (in that other actors are not significant).

The world market for abacá fiber dropped from 110,000 tons in 1974 to 60,000 tons in 1976. The current world market for raw abacá fiber has been estimated at 50,000 tons per year. It is constrained by the limited uses to which the fiber is applied. Total world production in 1981 was reported to be 86,700 tons.<sup>2/</sup>

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1/ Grade 1 fiber in late 1983 was being bought F.O.B. at US\$0.44/lbs. There is a 30% price differential between grades 1 and 5. Ecuador's exports were distributed in 1982 as follows over the five grades: 5%, 12%, 38, 25%, 20%. The price per pound for the same grades are currently (in US cts.): 44, 44, 42.75, 37.25 and 32.75. While Ecuador's fibre is said to be considered of relatively high quality, its relatively high price is a disincentive to the cordage industry.

2/ U.S.D.A., Foreign Agricultural Service "Foreign Agricultural Circular: Vegetable Fibers," July, 1981 p.7

A. Ecuador: Abacá exports by volume\*  
'000 tons

<u>1982</u>	<u>1981</u>	<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>	<u>1976</u>
8.7	10.7	10.0	9.7	10.3	9.6	10.2
<u>Percent exported to U.S.</u>						
80.6	88.7	84.3	92.2	91.9	93.3	91.1
<u>Percent bought by Dexter</u>						
66.1	68.3	65.1	69.1	72.1	70.0	72.7
<u>Percent exported by Cooperative Abacá Ecuador</u>						
45.5	44.3	36.4	35.8	42.9	38.2	45.8

B.1 Estimated World Abacá Production: 1983\*\*

	<u>Tons</u>	<u>%</u>
Philippines	71,000	85
Ecuador	11,000	13
Others	2,000	2
TOTAL	84,000	100

B.2 Estimated Exports of Raw Abacá Fiber: 1983\*\*

	<u>Tons</u>	<u>%</u>
Philippines	40,000	78
Ecuador	10,000	20
Others	1,000	2
TOTAL	51,000	100

Source: \* Collected abacá statistics of Ecuador, available from Adminconsult, Quito.

\*\* M.L. Gilmore

### Policy

The main institution of the Ecuador abacá industry in terms of impact at policy levels is the Asociación Nacional de Productores de Abacá, which represents the 350-400 abacá producers. Operating in a quiet fashion (receptions and dinners involving the key public sector decision makers; the placing of informative newspaper articles) the Asociación would seem to have been successful in representing the industry's interests to the government. They have gained important objectives which they sought - delayed removal of the export incentive (the abacá industry was the last exporting sector to lose the tax credit incentive at the end of 1983) and the Asociación persuaded the government to turn over to it revenues from the disease control program of the mid-1970's. But, given that the sectors markets are essentially private ones (with the exception of foreign exchange), the public sector policy level interventions have not proven to be critical. The general investment "climate", of course, is important and clearly affects the reinvestment decisions of the sector. The impression gained from talks with several of the key individuals in the sector and with other observers of the abacá industry, is that the producers are well linked both with their counterparts in the private sector and with the key policy makers. Internationally, the Association leaders know and are in contact with the abacá sector leaders in the Philippines and with the FAO's hard fiber section.

### iii. Major Institutions

#### Cooperative Abacá Ecuador (CAE)

##### Summary

CAE is the export-marketing consortium of small and medium abacá producers.<sup>1/</sup> It is composed of members who are of reasonable means and who have important military and professional ties. It has the basic capacity to efficiently buy and export. It has no technical or extension links or capacity. It would be an important organization to consider in framing any abacá related program.

### Resource Mobilization

The CAE receives a small percentage from the abacá sales of its members and with this base cooperates as a marketing organization. Its salaried staff apparently number, at most, five; all others are on a contract basis, each of which is piece work related. The CAE has been composed of military and professional people who had the capacity to secure land from the government and to ensure that quite substantial credits on subsidized terms would be available for cleaning, planting and development.

In recent years they have not actively sought to mobilize new resources to the members or to the CAE, or to the sector. They do operate with bank credits for the buying and storage of fiber.

### Resource Management

CAE runs quite a substantial operation, including six large (estimated 5,000 ton capacity total) warehouses. It buys, stores and exports 40 percent of Ecuador's abacá exports. Its internal systems for these operations are simple and effective. Very little actual cash is involved as almost all transactions are handled by checks writtens on a Santo Domingo bank account (BCI). As much as S/4,000,000 may be paid out in one six day week. While the appearance is that the CAE is adequately managed, no comment is being made as to efficiency or need for improvement.

CAE appears to "run" Monterrey, the small market town ("el Diablo" on some maps) center of the CAE area. It has a population of perhaps 2,500 and serves as a the main center for an estimated 10,000 people. It has 4 primary schools (escuelas) and 2 secondary schools (colegios) with a reported enrollment of 1,400, and two health centers, one private and one governmental. Monterrey is a comune, the lowest level of local government organization. CAE members say that they "created" Monterrey.

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- 1/ The sector's only other cooperative is a 25 member one based in Santo Domingo which buys from its members but which does not export directly.

### Opportunity Creation

The CAE does not provide technical information to its members. It does not allow new members to join (in this regard it is something of a closed guild) reportedly because of its view of the limited and non-growing market for the fiber. It clearly served as a formal development vehicle when in the early 1970's it was part of the legal framework under which land was granted to the individual members. (N. B., the members are also members of the area based cooperatives which are composed of owners of land in specific areas; the CAE membership is based on abacá production.)

### System Linkages

CAE is the largest organized group of abacá producers (130 to 170 members, both figures being supplied by the CAE). Its links with the poor, in Monterrey and in the field, are through its members, who are clearly the area's privileged group. Links with higher levels of the political system are unknown; presumably the members are not without influence. They have reported strong military and professional links. They rely on the Asociación to do any required representational work.

CAE is not linked to any sources of technical advice or guidance other than representatives of agro-chemical companies marketing inputs.

### Learning

The CAE's learning initiatives have focused on operating a smooth buying-exporting system. There is no system for evaluation, nor would such be expected given the guild like orientation of the organization. At a technical level, it has been suggested that CAE exports have grading and moisture problems. CAE does not appear to have had the capacity to address the issue.

## Adminconsult

### Summary

Adminconsult is one of the three private abacá fiber exporting firms.<sup>1/</sup> In addition to its commercial success, it is important because of the technical and promotional leadership which its president provides to the sector. It is the single most important source of data on Ecuador abacá. It is a respected organization which has the technical and management capacity to strongly affect any proposed abacá effort.

### Resource Mobilization

Adminconsult is the name given to a group of private companies owned principally by the Evans brothers, U.S. citizens who have been in Ecuador 23 years. The group now owns and operates some 1,700 has. in the Santo Domingo area (abacá, pineapple, cassava, livestock spread over 9 "haciendas" legally divided amongst four companies. It has a demonstrated capacity to mobilize information, financial, legal and political resources to develop quite an impressive agricultural development program. Figures are not available for the amount of resources actually at the disposal of Adminconsult, other than for land. They are clearly not insubstantial. There are 45 salaried (personal de planta) staff and 400-500 contract employees. They have recently hired a Ph.D level agronomist to manage their pineapple trials.

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1/ The other are two Furakawa and PATE, the latter in effect being two companies. Adminconsult is the major firm of the sector.

### Resource Management

The Adminconsult group is personally managed by the President, Mr. Edward Evans. It appears to be a group built by him and his brother and, seems to be a professionally managed and technically competent group of firms. With regard to abacá, Adminconsult is a major source of information. In interviews, Mr. Evans discusses Adminconsult's past and projected decisions on the basis of often quantified data. Adminconsult operates a small office in Quito and a large (480m<sup>2</sup>) warehouse in Santo Domingo.

### Opportunity Creation

Adminconsult is an important opportunity generator in the abacá system in Ecuador. It provides technical information (on a non-paid informal basis) to other growers. It buys and arranges the exportation of abacá produced by small growers who are not member of CAE, including the 25 members of Cooperative Agro-Fibra of Santo Domingo. It is perhaps the leading force in identifying abacá cropping alternatives. It is important in maintaining and attempting to expand international markets for Ecuador abacá. It is an innovative and energetic proposer of ideas (e.g. a paper pulp operation) for industrial development of abacá.

The caution to be maintained with regard to Adminconsult on this point is that its capacity has very much to do with the personal presence knowledge and management capacity of Mr. Edward Evans. It does not appear to be an "institutionalized" force as yet.

### System Linkages

Adminconsult is a fairly well connected organization. At policy levels within Ecuador it has played a central role in keeping government and other interested parties (e.g. the U.S. Embassy's agricultural attache's office) informed about abacá and in making representations to government when abacá interests are involved. Its horizontal links with other firms, with private sector leaders and with others in the abacá sector are extensive and apparently have generated a solid respect for the business and technical capacity of the group. It is difficult at this point to judge its relation with "the people" especially with the field workers, and small, non-CAE farmers.

The impression is that Adminconsult is a fair and fairly progressive firm. At the same time, it would appear to be strong on principles -- whether on need to move wage rates in line with basic family food costs (with which it seems to agree) or on the need to deal firmly with "invasions".

#### Learning Capacity

Adminconsult is the major "learner" in Ecuador abacá. It does this on a systematic basis through field records and observations. Organizationally, it has with success gone through several crises, it has continually adapted to changing market situations and will apparently continue to do so.

#### ASOCIACION NACIONAL DE PRODUCTORES DE ABACA

##### Summary

This organization is the producer's association for abacá. It is representative but small. Within its very limited range of activities it is well managed and effective. It has the respect of the members and of the public sector. It has no direct program implementation capacity at this time. It is a possible, and possibly essential, sponsoring organization for any abacá development efforts.

##### Resource mobilization

The Asociación has a small capital fund of \$/6,000,000. The earnings from this are used to finance the few activities -- e.g., representation, postage, phone calls-- which require funds. There are no paid staff; one of the staff of one of the exporting companies, Adminconsult, serves as secretary. The capital base was formed by the balance of the funds turned over to the Asociación by the government during the disease control campaign.

The Asociación has mobilized resources to the sector in the form of its role in securing and maintaining in effect the CAT (Certificado de Abono Tributario), and export bonus, up until the end of 1983.

##### Resource management

The Asociación manages few resources and has the minimum of internal systems.

### Opportunity creation

The Asociación has not been providing technical information, seeking markets or encouraging new investments, activities which might be regarded as developmental in the sense of creating opportunities. It has assisted in the documentation and facilitation of exports. It has the core legitimacy to serve as a base for such activities but it has not perceived itself, nor the prospects for abacá, as justifying an aggressive role for the Asociación.

### System linkages

The Asociación represents the 350-400 abacá producers. It is headed by five directors, three from the the primary exporting firms, one from Cooperative Abacá Ecuador, and one from Cooperativa Agro-Fiber which sells all its fiber to Adminconsult for subsequent export. The distribution of directorships is intended to ensure that control remains in the hands of the companies which have strong foreign (U.S., Dutch and Japanese) as well as Ecuadorean origins. There seems to be an inactive participation in the organization on the part of most of the members.

The Asociación's links with "the people" in the sense of the poor, here represented directly by the some 2,800 field workers, are as to be expected given the lack of organized worker representation. The Asociación could be characterized as "protective" in relation to this group, both in the sense of defending the Asociación members and in being somewhat "managerialist" in their approach to defining the workers' interests. The Asociación's self-description of its purpose is "defensa clasista".

### Learning capacity

The Asociación is headed and led by the president of Adminconsult. He would appear, at the moment, to be the strength of the Asociación and a person who provides, through his long experience, his knowledge, and the time he is willing to devote to it, an important learning capacity. The Asociación, as an entity, has no systematic learning capacity.

## 7. Issues from the case study-substantive

### The Poor

The poor in the abacá system are the lowly-paid agricultural field workers. Any effort to increase or improve abacá production will affect them. Some of the ideas proposed, e.g., those to increase mechanization at the critical harvesting stage so as to reduce total labor costs, would have an impact on the poor which should be examined closely. The trade-offs among higher productivity, lower production costs, lower prices (?) and expanded export sales (?), the sorts of assumptions made in discussions about mechanization, would need to be looked at in terms of factor incomes, especially to wage labor. As AID moves to strengthen the private enterprise system, of which the Ecuador abacá production system is an example, it will need to find ways to maintain its now "traditional" concern that the poor benefit. There are technical methods available for making the calculations as to trade offs, and they should be applied so as to fully inform the decisions which inevitably will need to be made.

### Extension

There is no extension system in Ecuador which addresses the needs of abacá producers. In fact, it is commonly said that there is no extension as such in Ecuador. This may appear to be a bit extreme, there are certain specialized commodity programs, and the Central Bank apparently has an extension program. Nonetheless, the question of how to (should one want to) mount an extension program in Ecuador is a broad based issue. As recently as several years ago, for instance, the IBRD was proposing that the basis of any such system should be a multi-skilled field or village worker. Another more recent and more focused approach, the "training and visit system" which has been tried with success and is being promoted by the IBRD elsewhere, would certainly be worthy of consideration in the case of abacá. As AID considers program assistance in the Ecuador agricultural sector, whether for export or internal commercialization, it will have to address the issue of how to channel research findings, advice, market and other information, to the producers. For abacá, Mr. M.L. Gilmore, on behalf of Dexter, the main buyer, is developing the outline of a proto-type system, one aspect of which might be its management control by the private sector. Its strengths and weaknesses as it is put into practice should be closely observed. Somewhat as an aside, I would note that much of the land presently cropped with abacá might be better suited for other uses. Also, there is probably a large amount of high

potential abacá land which is not in abacá. Thus, any extension effort should be based on a review of alternatives and not a simple, straight forward continuation of the present arrangements.

#### Product Research

A strategy of likely great importance in any concerted effort to increase abacá exports would be the identification of additional intermediary or final products for which the fiber has a special or comparative advantage. Such identification work, "research and development", in the field of fibers is an expensive one in which some of the world's largest companies are expending large sums and competing for vast markets. One should not be surprised to find existing patents covering abacá fiber uses which have not yet been commercially applied.

Should AID, given its programmatic interest in assisting Ecuador develop its export potential, enter into the field of abacá product development, which may be a logical choice, then it will confront issues both of institutional development and of private enterprise. On the former, the institutions to do the research and development work may not (likely will not) be located in Ecuador. On the latter, the interests of a number of firms, some of them U.S. owned and/or based, would be affected by a development assistance effort which was directed at the expanded use of a vegetable fiber. Success would affect price and demand levels not only for abacá.

#### Companies, Markets, Profits

The abacá system is one of private companies operating in largely free markets with the intention of making profits. On the Ecuador and the U.S. sides any development assistance intervention will have to take this context into account. For an idea of the sort of thinking which may sometimes be present in "official circles", it was suggested that the U.S. Embassy, in its annual agricultural situation report from Quito, would no longer include abacá, because it appeared that the information gathering was of benefit to only one company (Dexter). In other words, the appearance that a company may be benefiting (although I suspect that a company of Dexter's size and performance does not rely wholly upon the Embassy's annual report for the information) may be off-putting to some.

Certainly, those who have come to recognize the value of aid programs "targeted" on the poor, may have some difficulty in identifying the benefit flows in those more indirect initiatives which at an immediate level clearly benefit private enterprises.

Further, one can speculate as to the equivocal thinking of the private firms on the prospect of development assistance interventions in the abacá system, with all that this might imply of a focus wider than markets and profits. Certainly those private firms which have not come to recognize the value of development interventions might have some difficulty in identifying the benefit flows (as opposed to costs) to them. Should AID move into this type of private enterprise system it will want to have a thorough and open dialogue with the private enterprises involved. And, at least in the case of abacá, it will want to refrain from adopting a simple "hand in the cookie jar" stance; the companies involved in abacá are not successful for reasons of either grantsmanship or for reliance upon the public sector.

#### Institutions

The key institutions in Ecuador abacá are all either private companies or groupings "cooperatives" of private owners. As a whole the organizations are adequate given the limited no-growth view which the members hold of the abacá fiber market. Any significant program would, with the exception of Adminconsult in the technical field, quickly come up against organizational capacity constraints. This is, it would suppose, not unusual in the case of other agricultural production systems in Ecuador.

The issue of wholesale institutional development is always on the horizon -- if there is no organization doing a particular function, create one. This is the long-term, low probability approach which, in my view, should be a very last resort. Bearing in mind the limits of what can be achieved in a rural agricultural production system through the application of foreign technical and management leadership, which normally arrives in large amounts when starting institutions from scratch, and the general worthiness of an incremental, learning, adaptive approach to institutional development, I would suggest that the existing institutions be the basis for any program initiative. This would be neither 'clean' nor without sensitivities, but it would have a reasonable chance of being viable.

Issues from the case study - Methodological

First, the data used in compiling the abacá system description does not include that from two of the three large exporting firms. I estimate, however, that it does represent the picture on some 9,000 out of total of 12,000 hectares. Second, the data was compiled from interviews and published sources. None was taken from interviews with the workers, with the people of the areas, or with "popular" organizations. None was taken from an actual review of the internal accounting of any of the production units. In other words, it is what the producers, and, very indirectly, Dexter, were willing to reveal. There were, nonetheless, many differences of opinion which led to the subsequent verification of facts, and the main part of the report was reviewed in draft by those entrepreneurs most knowledgeable about the functioning of the system. Third, the data is based on a very brief field visit and a week of information review and interviews.

I hope that it has been demonstrated that a systematic approach such as used here combined with a dynamic or capacities approach to institutions, can yield an informative perspective in a rather short-time. The issue, then, becomes how reliable is such an approach given the very complicated social and agricultural system aspects involved. In my view such an approach represents an institutional environmental scan, one result of which is the preliminary identification of development opportunities. Obviously, it is not adequate to serve as the basis for any firm programmatic decisions.

The approach with its rather extreme rapidity and narrow base of informants, is probably weakest, in a general sense, in providing the basis for verifiable judgements on organizational capacities. Much of any success achieved in gathering the data to support such judgements depends on skill (e.g., interviewing and data selecting) and good fortune (e.g., access to informed and helpful individuals, reliable secondary data sources). If these are not likely to be available, the approach would certainly best not be attempted.

Issues from the case study - Conceptual

The main conceptual issues, in my view, are where does one draw the system boundaries, how does one define the system's components and how does one judge the capacity of any one of the system's many organizations.

The system boundaries adopted are based on a view of abacá as a commercial agricultural production and marketing operation. A social system view of, for instance, Monterrey (the CAE area) or of Santo Domingo would have been of equal merit and led to quite a different outcome. My view is that the system definition should be purpose dependent, and in this case programmatic interests in agricultural commercialization were foremost.

As to the issue of how one then in turn defines the individual components of an agricultural system, I adopted a somewhat quick common sense and abacá-related scheme. There are elegant frameworks for agro-systems available in the literature and in doing any additional work one might want to consider employing them.

Judging the development capacity of an organization has been a 'soft' field in the best of times. This is not to say it cannot be done, nor that the specialized capability to do so cannot be learned. Rather, that it is an endeavor which relies upon subjective assessments. These can be improved as the quality and, in some cases quantity of data available increases; they can be improved through the use of acceptable research methods; they can be improved through the use of an analytical framework which is tied to the capabilities being sought. In my view, precisely because of this inherent softness or subjectivity, these organizational capacity assessments are the most difficult and most critical of any study of the program needs of a sector.

ECUADOR

SOCIAL AND INSTITUTIONAL PROFILE

PART II

LOCAL GOVERNMENT

Prepared by  
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for the

U.S. Agency for International Development  
Mission to Ecuador

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## BACKGROUND AND INTRODUCTION

### BACKGROUND

A few months ago, the newly-appointed Director of Ecuador's Development Bank (BEDE) visited the office of the AID Mission in Ecuador to discuss possible working relationships. Among the areas of potential collaboration, one emerged as the most obviously in need of attention: the present and potential role of municipalities.

Among AID and BEDE officials, a consensus was reached that municipalities are at present ignored actors in the process of development of the country. It was suggested that local governments were not only not contributing in any significant manner to the progress of the country, but that they draw significant revenues in the form of transfers or grants. This is a disincentive for the municipalities to be more responsible for their own financial operations.

Several other hypothesis were formulated. An important one is that municipalities in Ecuador do not seem to have adjusted to changes in the roles expected of them, as part of the institutional framework of the country. Ecuadorean municipalities, up to the last three or four decades, were probably the most important of all public sector institutions, with a capacity to legislate and to enforce their own policies and regulations for most matters of community life. At that time, Ecuador's smaller cities were largely isolated, closed-in societies. With improvements in communications, municipalities became more and more dependent on central government, and resigned to it the control over many administrative and financial functions. It was also hypothesized that municipalities have not adjusted to the new roles demanded by changes in the agrarian reform process, since the old hacienda system was abolished, and nothing replaced it as the principal mechanism to market and distribute farm goods. It was expected that rural service towns would adopt those new roles, but that seems not to have been the case.

One of the most challenging aspects of Ecuadorean Development is whether the municipalities can become again significant actors in the development process. To do so, major changes are probably needed, and must be identified. Municipalities need to find a new life of their own, and a new self-reliance, abandoning the unfortunate process of dependence on transfers and decisions from other government agencies. Can municipalities do this? Can municipalities become new actors in the development process of the country, bringing at the same

time new impetus to the development of Ecuador's secondary cities and small towns? These are questions which AID and BEDE were jointly to try to answer. These thoughts and initiatives, prevalent in the first conversations between the Ecuadorean Development Bank and AID, were later shared with other GOE agencies, who expressed similar concerns and willingness to participate in an initial diagnosis.

At roughly the same time, AID/Washington's initiative to carry out research on the social and institutional profile (SIP) of various countries was being explored. Thus, a door was opened to test some of the hypotheses, and to start analyzing whether there was merit in the idea of emphasizing--within USAID/Ecuador's country development strategies--the strengthening of local level public administration units, as a necessary complement requisite to the grass-roots private sector development which is expected to be the major focus of this new development strategy. Initially, secondary city and still smaller governmental and parastatal institutions were meant to be analyzed, including regional, provincial and other sectional bodies. This first stage study focusses primarily on municipalities, mentioning regional and provincial entities as they affect municipal development.

This study focuses on a description and analysis of municipalities as significant development institutions. The SIP is a USAID-directed effort, carried out in close collaboration with pertinent GOE agencies. Moreover, the study is meant to be not a final product, but the initial step in an on-going process. Follow-up investigations will be carried out, to arrive at the levels of detail needed to inform programmatic decisions and actions.

#### OBJECTIVES AND EXPECTED OUTCOME

The study is meant to test various hypotheses. Underlining these is the broad supposition that municipalities are not at present performing up to their potential, and that, with the support and catalytic action of various entities (including AID), municipalities can become again significant actors in the development of the country.

The study seeks to provide initial answers to the following questions:

1. Can local needs in Ecuador's secondary cities and small towns be met increasingly by local resources, at a time

when Ecuador's central finances and capacity are undergoing stressful change?

2. What is the actual level of municipal "autonomy"?
3. What is the local government capacity to carry out actions such as development planning, project planning and execution, provision of basic services, and the financial planning and management needed to guide and support these actions?
4. What are the attitudes and style within which municipalities involve, including their formal and informal relationship with other levels of government?
5. What are the most critical problems confronting the municipalities in Ecuador, constraining them in the process of participation in the development process?
6. What are the causes of these problems?
7. What are the positive achievements that indicate the feasibility of developing municipalities into relevant actors in the progress of the country?..
8. What are the current financial conditions of municipalities, as a whole as well as in selected case studies? What is the income and expenditure situation? What are the implications for municipalities of current financial conditions confronting the country?
9. What is the impact of financing agencies on the economies of the recipient municipalities? Does borrowing have a significant impact on future revenues and expenditures?
10. How can municipalities generate new sources of income and revenue? Can, for example, the cadastral and local taxation processes be turned into significant sources of self-generated revenues?
11. What additional areas of study, discussion with the GOE, or pilot activities are suggested by the current situation and potential future of local government?
12. What does the present diagnosis suggest for the various sectors and means contemplated in the USAID development strategy over the next few years?

## METHODOLOGY

From the start, the research for the SIP was intended to focus on three areas: the financial situation, institutional/legal relationships, and project-specific needs and demands. Later, it was found that, within each topic, a whole universe of individual concerns, each to be addressed individually, could be identified.

Two methods were used to arrive at that analysis, and through it, at answers to the questions and hypotheses cited above. The first one was to identify and contract recognized leaders and researchers on local government in Latin America. The second one was to initiate, with GOE agencies, a process of reaching municipalities to dialogue and discuss with them their own perceptions of needs, problems and potential. Through these two methods, USAID/Ecuador sought a range of perspectives on municipal conditions and prospects which would assure a high degree of reliability of the findings and recommendations contained in this report.

The consultants responded to significantly different scopes-of-work. Pirie Gall was asked to look at municipalities as a whole, inasmuch as it would be possible to rely on secondary sources, and to open a series of conversations on the perceptions of public sector agencies, based in Quito, of municipal performance. His report examined a series of issues in municipal administration and development, from the standpoint of central government officials. These issues were further illuminated by his direct contact with municipal officials and representatives of non-governmental organizations in four local governments from various regions of the country.

Mauricio Silva was asked to look into the institutional, legal and political aspects of municipal action. He also approached this from the central and local perspectives. He identified, interviewed, and analyzed some fifteen entities which affect municipal administration, including national-level, central government agencies, financial lending institutions of the public sector, municipal associations, regional development agencies, and training institutes. Their opinion was matched with those of at least fifty municipal government officials with whom he had the opportunity to meet. From these perspectives, Mr. Silva assessed the possibilities and mechanisms for interagency collaboration.

The Research Triangle Institute (RTI) team, headed by James Hicks, was asked to adopt a quantitative approach to the analysis of municipal finances, and to arrive at projections

from this baseline. They analyzed the 1981 financial condition of municipalities as whole, using data aggregated at the national level, as well as basic revenue and expenditure patterns of a sample of twenty-two municipalities. The RTI group adopted a matrix of representative municipalities of the Coastal, Sierra, and Oriente regions, subdivided in three empirically determined municipal population classifications. The computer-assisted projections requested from RTI appraised the levels to which locally raised revenues would have to increase, in order to account for possible changes in central government transfers and in the borrowing capacity of the municipalities. The RTI team was also asked to offer suggestions for improving municipal financial management.

David Greytak's two visits to Ecuador were meant to look closely into BEDE's municipal lending operations, including processing and approval of applications, loan team, debt service capacity and the impact future finances. In addition Dr. Greytak assessed the levels of commitment and the capacity for BEDE to become a leader in the process of municipal assistance in Ecuador.

During the same period, working with the BEDE and the National Pre-Investment Fund (FONAPRE), USAID sponsored a complex and lengthy process of reaching all of the municipalities in order to assess their needs and potential. Through this innovative three-way partnership, a series of seven regional one-week meetings were carried out. The BEDE/FONAPRE Program was initiated as the first step in a process of channeling technical support to municipalities. This was done by means of assessing their demands financing infrastructure projects, their concerns for their managerial capacity, and their experience with the processes of negotiation over clearances, approvals, and funding with the several pertinent government agencies. The meetings included a series of bilateral conversations with each individual municipality as well as the collection of two surveys, one on basic municipal data with comments on financial, project-specific and administrative aspects, and one survey which gathered the comments of the municipalities on the follow-up actions which they expect should be carried out.

#### A. THE SYSTEM OF LOCAL GOVERNMENT IN ECUADOR

This section establishes the framework of our analysis. It describes (1) the legal and organizational structure of sub-national government in Ecuador; (2) the urban hierarchy and the variety of types of municipalities; (3) the national agencies that presently exert the most influence on local

administration, and finally (4) depicts a day in the life of a municipal council chairman of a market town.

## 1. Overview of the Structure and Functions of the Local Government System

### 1.1 Municipal Level

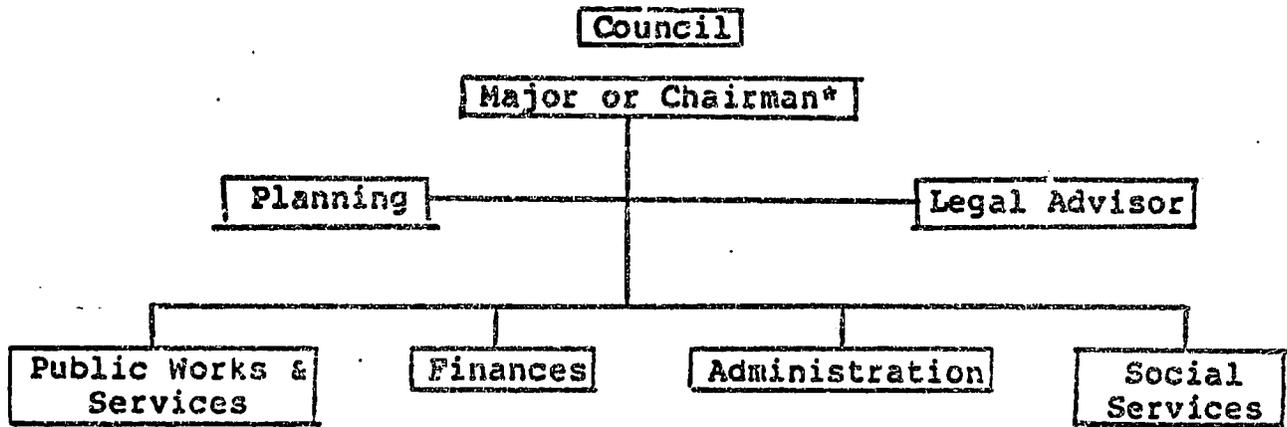
There are currently 126 municipalities in Ecuador, distributed among the 20 provinces. 57 are located in the ten Sierra provinces, 46 in the five coastal provinces, 20 in the Amazon (or Oriente) region's four provinces, and three in the Galapagos Islands. The average size of municipalities and capital towns is highest on the coast, followed by the Sierra, with the smallest ones in the Amazon and the Galapagos. The municipalities' jurisdictions include rural areas (the town and rural area together are also called a cantón), and the percentage of population outside the town center may range from 50% to as high as 90%.

The Municipal Law governs the major functions of the local government system, and was most recently reformed in part during 1981-82. Changes to 440 articles were proposed by a study team of the Association of Municipalities, of which 140 were passed by the national legislature. There is a separate law governing provincial councils. Municipalities are also subject to the dispositions of national laws regarding public sector finances, procurement, personnel, and are expected to plan their investments with reference to the current national development plan.

The Municipal Law is discussed in section B., so a few observations will suffice for the purposes of this section. Like laws of its kind elsewhere in Latin America, the document has a long history, has been amended numerous times, and goes into extensive detail regarding procedures, management of municipal property and finances, and even establishment of rates for certain taxes and services. It reflects a highly centralized and regulated view of local government, and in the opinion of a number of Ecuadorian administrators is overdue for thorough restructuring. Given the complexities of this legal structure, it is not surprising that even the smallest municipalities have a legal advisor working full time for the mayor.

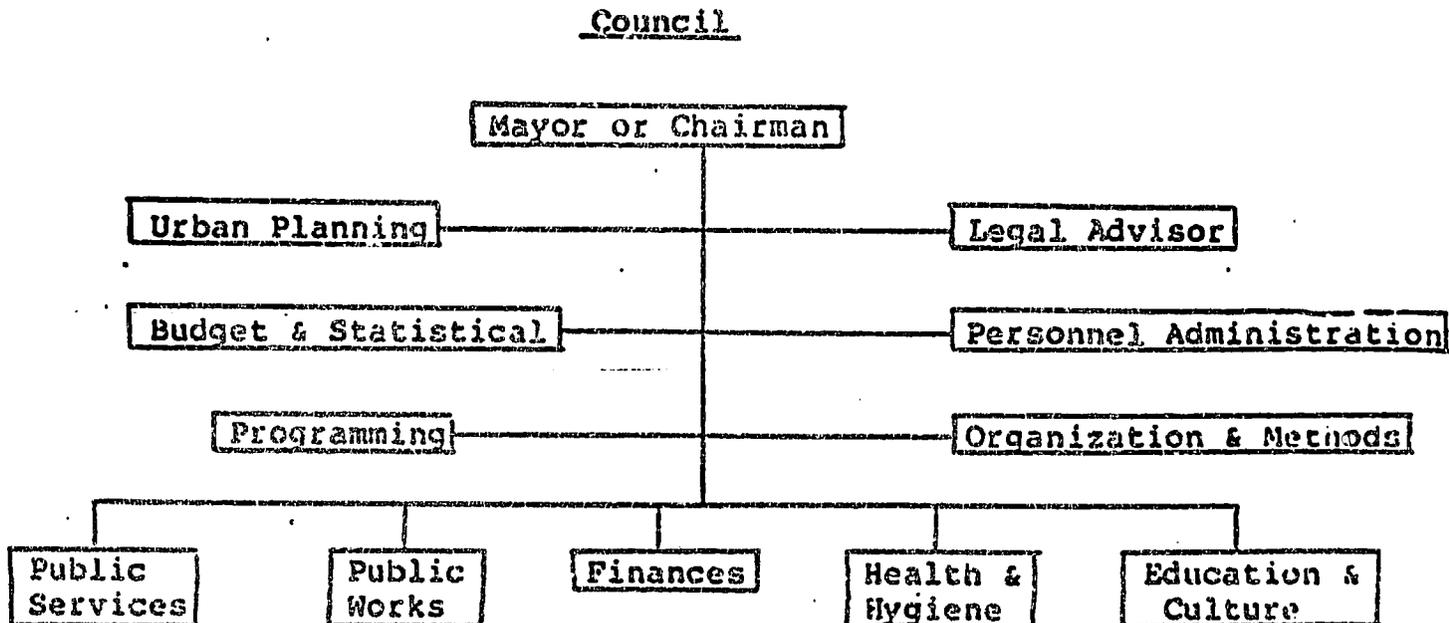
The organizational structure of municipal government is established in the Municipal Law. The minimum structure, for municipalities having annual income of less than S/.5

million (of which there was only one in 1981, according to the Controller General's report for that year) is:



\* Mayors are separately elected administrators of provincial capitals; council chairmen are administrators of other municipalities, elected within the council.

Municipalities having more than S/. 5 million income are to have the following structure:



Municipalities are expected to expand and adjust these organizational patterns as necessary to fit local situations. In reality, the structure and nomenclature of the operating units of most municipalities follows that shown above, while the advisory or staff functions (other than legal advisor) are seldom as complete or organized in the way indicated by the municipal law, except in a few of the larger provincial capitals. The budget function is likely to be lodged in the financial department, personnel under the council secretary, and the planning, statistical, and O&M functions absent.

The law encourages municipalities to establish both economic and physical (urban) plans, but for reasons to be explored below, such plans are rare.

Municipal employees are hired in two broad categories, employees (meaning professional and administrative staff) and workers (drivers, mechanics, sanitation laborers, etc). The employees' terms of employment are covered by the national civil serviced law, while workers' conditions are covered by the national labor law, and in many municipalities by union contracts.

Municipal councils now hold office for five years. In smaller municipalities, there a seven council members including the mayor or chairman, in medium-sized ones nine, and in the largest ones 13. Only the mayors and chairmen receive payment for service to the municipality.

The three overall goals of municipal government are as follows:

1. Promote the material welfare of the collectivity and contribute to the development and protection of local interests;
2. Plan and promote the physical development of the canton and of its urban and rural areas;
3. Increase the spirit of nationality, civic spirit, and brotherhood of the citizens to achieve progress and unity of the nation.

The principal functions of the municipality under the law are:

1. Provide drinking water and sewage systems;
2. Construct, maintain, clean, beautify, and regulate

- the use of roads, streets, parks, plazas, and other public spaces;
3. Collect, process, utilize waste material;
  4. Provide and maintain public lighting;
  5. Control the processing, handling, and distribution of basic foodstuffs;
  6. Police the public morality and behavior;
  7. Control construction;
  8. Authorize the operation of industrial, commercial, and professional establishments;
  9. Provide cemetery services;
  10. Develop tourism; and
  11. Provide slaughterhouse and market place services.

These are the familiar time-honored functions of municipalities in Latin America, largely of a social service and infrastructure nature, and primarily urban in focus.

The range of financial resources available to Ecuadorean municipalities includes:

- a. income derived from the sale, use, or rental of municipal assets;
- b. transfers or subsidies from the central government or other public entities;
- c. loans from national or international banking institutions;
- d. taxes, service fees, or improvement levies; and
- e. fines or fees.

Municipalities may levy taxes on urban and rural property, property transfers and registry, vehicles, public entertainment, capital gains or property due to municipal improvements, and they may issue business licenses. Service fees may be charged for construction approvals and inspections, slaughter of livestock, potable water, sewage and drainage, electric power, solid waste collection, and the like.

### 1.2 Provincial Level

The provincial councils are a more recent creation than the municipal structure. The Provincial Code establishes the following aims for the 20 provincial units: (a) promote the progress of the province; (b) carry out public works and provide services; (c) coordinate the action of the municipalities; and (d) oversee the sanitary conditions of the province through joint action with the municipalities.

In practice, the provincial councils concentrate their efforts principally on the construction of roads, schools, tourist complexes, and other special projects. Most have adequate fleets of road maintenance equipment, which they share with municipalities.

The organization of the provincial councils is similar to that of the municipalities. The top authority is the council, to which the prefect reports. Both the council and the prefect are elected by popular ballot for four years. The number of councillors varies from five to nine (with the population of the province). Municipalities are not directly represented on the provincial council.

Provincial councils' budgets are almost entirely funded by central government transfers, although the Provincial Code does confer limited taxation powers on them. In their financial matters, the provincial councils are regulated by the same central agencies and procedures as the municipalities. The provinces work most closely with the Ministries of Public Works and Education, although the degree of cooperation and coordination varies considerably among provinces.

### 1.3 Regional Entities

There are five regional development entities in Ecuador, each created at a different time for a different purpose. CREA (Centro de Reconversión Económica del Azuay, Cañar, y Morona Santiago), and CRM (Centro de Rehabilitación de Manabí), are under the Ministry of Agriculture; INGALA (Instituto Nacional de Galapagos), and CEDEGE (Comisión de Estudios para el Desarrollo de la Cuenca del Río Guayas), under the Presidency; and PREDESUR (Programa Regional para el Desarrollo del Sur del Ecuador), created to develop the conflicted border region with Peru, under the Ministry of Foreign Affairs.

CREA, one of the more active regional development agencies, was examined for this study. It was created in 1959 as a branch of the Ministry of Agriculture to assist in the integrated development of the provinces of Azuay and Cañar (both in the Sierra) and Morona Santiago in the Oriente. CREA receives 90% of its budget from the Ministry, the remainder from income from assets and some minimal (subsidized) service charges. It has 260 employees, of whom 76 are professionals, plus 400

laborers. About half of the professional staff have received specialized training.

CREA engages in a wide range of development activities, and in recent years has moved from planning, coordination and assistance to a more direct role in project implementation on a regional scale. The agency seeks to hand over to local authorities the projects it has initiated, once the local bodies are prepared to absorb them. CREA has promoted industry, setting up an industrial park. It has provided artisan training; carried out a range of agricultural activities; and through contracts with technical ministries, has implemented a number of infrastructure works (schools, roads, health centers, etc.). CREA carries out preinvestment and macro studies of the development of the region, in coordination with the National Planning Council (CONADE). It has recently begun a pilot program of technical assistance in administrative matters with municipalities.

## 2. The Urban system and a Typology of Municipalities

### 2.1 Redistribution of Urban Growth

Like other countries in Latin America, Ecuador is rapidly becoming a predominantly urban society. In addition, the patterns of rural-urban migration are changing, with a wider distribution of urban growth outside the primate cities of Quito and Guayaquil<sup>1/</sup>. Since the previous census in 1974, the two main cities (about a million people in each of the metropolitan areas) grew by about 45%, while the next range of cities and towns (150,000-20,000) grew by an average of 50%, and the next smaller group (20,000 - 10,000) grew by an average of 66%.

Research shows that there is a step-wise pattern to this migration from rural area to small or intermediate city, and thence to the primates. People of the sierra are migrating the most, with cities in the Pacific coast region showing the highest rates of expansion. Certain

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<sup>1/</sup> This information is from Richard Wilkie, Clark University geographer who compiled urban growth data from the preliminary results of the 1980 census, and Carlos Luzuriaga's excellent 1980 paper on "Issues of Human Settlements in Ecuador" (USAID/Quito).

sierra market centers (some of them small and sleepy certain days of the week, sprawling and dynamic on other days) are showing rapid growth, or at least an increasing demand on their limited urban services, transportation networks, and the like. This change is producing unmet demands for housing, employment, social services, infrastructure, support for the modernization of agriculture production and marketing, and a series of other needs not previously encountered in these smaller urban places.

## 2.2 Types of Municipalities

There are a number of ways of characterizing the differences between the local jurisdictions in Ecuador, and of categorizing them for descriptive and resource allocation purpose. The Government of Ecuador (GOE) has not yet established an official typology of municipalities. In order to illustrate the range of conditions in the jurisdictions, we have selected some key indicators to divide the 126 municipalities into four groups: (a) metropolitan, (b) urban, (c) semiurban, and (d) rural. The indicators include population, settlement pattern, and level of access to selected basic services (water supply, sewage, paved streets, etc.) Exhibit A-1 on the following page shows the typology, and the numbers of municipalities falling into each category.

As the chart shows, Ecuador's municipalities are over 60% rural, with the others (apart from the two primate cities of Quito and Guayaquil) made up of small towns and intermediate cities. Taking the rural and semiurban municipalities as a group, 85% of the jurisdictions lack sufficient provision of basic infrastructure. These problems are acute in both the dispersed rural communities of the Sierra, and in the growing towns of the coastal region.

The classification of a municipality in one category or another should not be equated with potential importance for development. In the urban group are Sierra towns which have shown little growth or change in recent years, while in the rural group, there are burgeoning market centers in each of the three main geographic regions which are potential investment targets. A more complete and sophisticated typology is needed in order to serve as the basis for planning a program of funding and technical assistance.

**EXHIBIT A-1**  
**TYPES OF MUNICIPALITIES**

<b>CHARACTERISTICS</b>	<b>RURAL</b>	<b>SEMIURBAN</b>		
<b>URBAN METROPOLITAN</b>				
<b>Size of population</b>	Cantón: 0 - 50,000 HQ Town 0 - 10,000	50,001 - 100,000 10,001 - 40,000	100,001 - 1 million 40,001 - 400,000	Over 1 million Over 400,000
<b>Annual Budget</b>				
<b>Settlement pattern</b>	Small dispersed villages	Small communities and one main town	More than two major towns	Major concentrations and important towns.
<b>Basic Services</b> (% of population with access)				
Potable water	Less than 10%	Less than 50%	Less than 70%	More than 90%
Sewage	" " "	" " "	50% - 70%	70% or more
Street lighting	" " "	" " "	Less than 70%	More than 90%
Paved streets and sidewalks	" " "	Less than 30%	Less than 50%	More than 70%
Trash collection	Absent	Insufficient	Insufficient	Adequate
Schools, health services	Minimal	Insufficient	Insufficient	Adequate
<b>Number of Municipalities</b>	<b>79</b>	<b>29</b>	<b>16</b>	<b>2</b>
<b>Total (126)</b>				

### 3. National Agencies Affecting Municipal Administration

As noted earlier, Ecuador is rich in laws related to municipal (and general public) administration. So is it rich in institutions that play important roles in municipal business. What follows is a description of (1) the units of the central government which by law or custom are involved with municipal finances, planning, and project implementation and (2) organizations of municipalities for mutual benefit. In Section B is a more evaluative analysis of how the relationships work in practice, and of the trends in national-local collaboration for development and basic administration.

#### 3.1 Central Government Agencies

##### National Development Council (CONADE)

The National Development Council is chaired by the Vice-President of Ecuador and is responsible for the formulation and supervision of the national development plan. It exercises budgetary supervision over all public sector entities, including provincial councils, municipalities, municipal enterprises, and port authorities. Its regional, rural, and urban planning units provide advice (and at times in the past) direct services to local governments on matters of physical and socioeconomic planning.

The Division of Fiscal Coordination and Policy for the Public Sector seeks to assure that municipal investments are reflective of national development priorities, and in cases where a local development plan has been prepared, that local projects are in accord with the plan. This CONADE office is also responsible for seeing that provisions of the national laws regarding public spending and finance are adhered to by the municipalities. The review of annual budgets (which takes the form of an "opinion" to be issued within 60 days of budget submission by the local government) seeks to assure that the municipality (a) has the financial capacity to make the planned expenditures, (b) spends its funds according to the corresponding laws, (c) finances its investments and operating expenses under the correct headings, and (d) that the municipality's proposed investments are technically acceptable.

The Section for Decentralized and Local Entities analyzes the budgets of 126 municipalities, 19 provinces, and 13 municipal enterprises (water/sewer, electricity). The staff

of eight professionals in the Section seeks the cooperation of other CONADE Divisions in its reviews of local budgets. The Regional Studies Division advises on matters of regional and urban development and basic services, while the Social Development Division advises on plans for housing, sanitation, and education. The municipality or province develops its budget, and it is approved by the corresponding elected council and sent to the Fiscal Coordination Division of CONADE. That Division does its own analysis and consults with the other Divisions, and issues its opinion. If favorable, the budget is sent to the provincial governor for sanction, and it goes into effect. If unfavorable, the CONADE staff will explain its opinion to the municipality and seek corrections from the local officials. CONADE can inform the Ministry of Finance to "immobilize" transfer payments until agreement is reached with the municipality. If CONADE offers no opinion on the local authority's budget within the specified time period, it automatically goes into effect.

#### Ministry of Finance

Transfers from the central government are a major source of funds for the municipalities. The magnitude and consequences of this are discussed in Section B. The Ministry of Finance controls municipal transfers through the Disbursements Section. There are two kinds of funds, those that are automatically retained portions of national taxes set aside by law for municipalities to use as they wish, and funds for investment. These latter funds are restricted in their use for "priority" purposes, and are more closely controlled by the Disbursements Section. The criteria for establishing "priority" are legally supposed to be established by CONADE, but the Ministry maintains that they have received no such guidance, and they have therefore established their own criteria.

Government transfers to the municipalities come from four sources; special funds, the National Participation Fund (FONAPAR), petroleum revenues, and two percent of the net current income of the national budget. The special funds are provided for specific projects by action of national legislators or the President. In 1983 this amounted to S/. 2 billion. Petroleum revenues are provided directly by the Central Bank, in fixed amounts of S/.250 million per year per municipality, beginning in 1981. The petroleum revenues are supposed to be used "specially" for investment purposes, but municipalities are using them increasingly for operating expenses as well.

The recent Decree on Regulation of the Economy and Public Expenditures established a top limit of S/.60 billion for the net current income of the national government, of which two percent would be for municipalities. This means S/.1.2 billion for provincial capitals only, with 25% each for Quito and Guayaquil, and the remaining 50% distributed among the other provincial capitals.

The FONAPAR is an amount which varies every two years, and is drawn from a variety of sources. 40% is automatically retained and disbursed for local use, and 60% is to be for investment purposes only. The sources are (a) tariff rights (S/. 720 million per year ); (b) 10% of the income tax; (c) fixed percentages of petroleum income (6.073% from Texaco and 3.484% of the income of the Ecuadorian Petroleum Company -- CEPE); (d) 40% of the cigarette tax (e) 100% of the income from tax stamps; (f) taxes on exports (S/.3.65 million per year); and (g) 1% of import duties.

The Ministry controls each of these accounts, how much is distributed to each municipality, and approves the projects to be built with the funds. Once the Ministry has approved a project, it advances up to 30% of the funds needed to construct it. The rest is paid against invoices paid or other justifications. This often causes problems for municipalities, especially near the end of the fiscal year, when the Ministry's disbursements are often delayed, and municipalities must either finance the project from other funds, or stop construction.

These controls are handled by computer, and are apparently current. The Section wants to improve its controls, and is preparing to offer courses on budget administration to the municipalities.

#### Controller General

The Controller General carries out operational, financial, and special audits of all public organizations. For this it receives 5% of the budget of all public agencies. The Municipal Code and the Financial Administration Code require that the Controller General audit the municipalities. This is done on the basis of the budget passed by CONADE, and is done selectively (a few municipalities each year, and on selected parts of the municipality's operations).

The Controller General uses internationally accepted audit standards. Its services are respected by the public institutions. It has recently established (since 1981) a standard accounting format for all public agencies. The Controller General maintains a training school for public employees on such topics as basic laws, accounting, auditing, and project control.

#### Attorney General

Apart from its role as the prosecuting body of the state, the Attorney General oversees all procurement of goods and services by the public sector. This means that municipalities must submit any requests for bids on local projects to the Attorney General for a legal opinion before they are issued.

#### Ministry of Government

Chapter IV of the Municipal Code regulates the relations between the municipality and the central government, represented by the Ministry of Government, which has a Sectional Affairs Directorate to oversee municipal relations. The specific functions provided in the law for the Ministry are to (a) intervene to take over municipal administration if it is paralyzed; (b) oversee the proper administration of the municipalities; (c) respond to inquiries from municipalities; (d) call for audits or fiscal reviews; and (e) bring charges in case of wrongdoing. During times of dictatorship, the Ministry named the mayors and council members.

In practice, the main function of the Sectional Affairs Directorate is to approve or reject any transfers of fixed assets of municipalities, in order to protect the patrimony of the municipalities. Also, when the municipality expropriates property and there is a dispute with the owner, the Ministry acts as judge. The Ministry also sanctions the budget of the Province of Pichincha, which has no governor to perform this function, and approves the creation of municipal parishes.

The Ministry of Government distributes and supervises the special grants provided through the Chamber of Deputies for communal projects of the municipalities. The Ministry has not yet used its power to bring judgement against a mayor or council member, but it has intervened in the case of the Municipality of Sucre, where the council disbanded because of internal disputes.

The Sectional Affairs Directorate has a staff of ten persons, two of whom are professionals.

Ecuadorian Development Bank (BEDE)

The BEDE was established by Decree No. 774 in August, 1979 as an autonomous stock company. BEDE incorporated the existing programs, operations, personnel obligations, and responsibilities of the National Development Fund (FONADE) and the Municipal Development Fund (FODEM). The Bank's statutory mandate is to provide credit finance for programs, projects, works, and services to all segments of the public sector -- municipalities, provincial councils, autonomous agencies, and the various ministries.

Municipal lending is but one part of BEDE's activities, which include financing of major projects of technical ministries, and providing the national counterpart funds for loans from the World Bank and the Inter-American Development Bank. It was capitalized with an initial fund of S/.25 billion and the loan portfolios of FONADE and FODEM. BEDE's income is derived from the proceeds of its loan portfolio, fees and commissions, the petroleum participation fund, and from FONAPAR.

BEDE makes loans only for the actual construction phase of project development and implementation. Its priorities are established by national development guidelines and the following criteria:

- a. Projects included in the national Development Plan or those considered by the national government to be of major importance;
- b. Projects which will remove major obstacles to local, regional, or provincial development;
- c. Projects which will generate new stimuli to local development;
- d. Work projects to be carried out in areas of high social marginality;
- e. Balanced distribution among provinces, giving minimal spatial coverage;
- f. Projects which permit the exploitation of natural resources and thus promote related employment in the regions, and
- g. Capacity of the entities to carry out the project and bear the debt.

To date, BEDE has approved 46 loans, 20 of which are to municipalities. The 46 are distributed as follows: water supply-8, roads -10, sewage -14, markets -5-, canals -3-, electricity -2, and others - 4.

The loan application, approval, and implementation process of BEDE has three main stages: (a) presentation and review of the application by BEDE, (b) review and approval by other central agencies (Ministry of Finance, Central Bank, CONADE, and the Attorney General), and (c) contracting and disbursement.

The municipality is responsible for the preparation of the loan application, drawing on its own staff, seeking assistance from technical agencies, or hiring consultants. The documentation required to start the process includes (a) a formal request, (b) technical plans for the project, (c) a detailed project budget, (d) a calendar of implementation, (e) a projection of income to be generated by the project, and (f) proof of local approvals and support for the project. Once this documentation is considered complete and technically sound by the Bank, the Board approves the project, and sends it on for a total of sixteen more steps before the first disbursement. Given the various factors involved, the entire process may take as much as a year to complete. BEDE currently is not placing loans as quickly as projected (only 33% of planned in 1982), and has a considerable backlog of incomplete or unprocessed applications, 475 by recent count. 149 of these (worth S/.5.9 million) are in planning or review by CONADE. The remaining 36 have completed studies, and are in various stages of processing.

BEDE loan terms vary by type of project and length of amortization:

TABLE 1

	AMORTIZATION TERMS		
	Up to <u>3 yrs.</u>	<u>Amortization Process</u>	
		<u>3-5 yrs.</u>	<u>5 + years</u>
Export and Agriculture Promotion Projects	8%	9%	10%
Others	12%	13%	14%

Source: BEDE Internal Documents

They include a 2-year grace period, a one-time service charge of 1.5 percent of the loan value, and a commission charged annually which is equal to 1.5 percent on the unspent loan balance. The majority of the loans granted have been for ten years with interest rates of 10 or 14 percent.

TABLE 2

AMORTIZATION TERMS OF GRANTED LOANS

<u>Interest Rate</u>	<u>Number</u>	<u>Length</u>	<u>Number</u>
10%	23	5 yrs.	2
11%	6	8	2
13%	1	10	39
14%	15	13	1
		17	1

Source: BEDE Internal Records

Municipality's capacity to service BEDE debt is determined by the amount of revenues it received from the central government (FONAPAR) minus other debt obligations. The debt service obligation of a municipality to BEDE is deducted from its FONAPAR transfer funds prior to their distribution. Collateralizing and collecting debt service in this fashion minimizes the risk of arrears and default as a unilateral decision on the part of a debtor municipality. To the extent that a creditor's share of the FONAPAR transfer funds does not fall below existing amounts, BEDE loan repayments are guaranteed and its portfolio of loans to municipalities is risk free.

National Preinvestment Fund (FONAPRE)

FONAPRE's purpose is to carry out or sponsor the preparation of studies, up to the final design stage, of development projects. It is a public agency offering credit to other public entities. Its board is chaired by the head of CONADE (the Vice-President), and includes the Minister of Finance and the Secretary General of the National Security Council. The Fund is organized in three technical Divisions (Agricultural Development, Physical Infrastructure, and Urban Development) as well as an Administrative-Financial Division and a Programming and Coordination Division.

The three technical divisions provide advice and guidance to borrowers in applying for preinvestment study loans, and in contracting with consultants to carry out the studies. The Financial Division Studies the debt-carrying capacity of the borrower, audits the funds, and advises on accounting. The Programming and Coordination Unit offers training, control of documents and operations, and coordination of international agreements (FONAPRE itself borrows from the World Bank and the IADB).

The Fund's principal borrowers are the major technical agencies of the central government, such as the electric authority (INECEL), the Ministries of Agriculture and of Public Works, etc. However, the 1982 Annual Report shows that the number of loans to municipalities for studies is growing, particularly in the areas of urban plans, cadastral studies, and studies for specific works such as water supply and a port. Of the 72 studies completed or in progress during 1982, 11 (or 15 percent) were for municipalities. Plans for the coming year show 38 approved and being processed for disbursement, of which 13 (or 34 percent) are for municipalities, principally intermediate cities.

The terms of FONAPRE's loans are geared to 60% of the maximum rate established by the Monetary Board (presently 9.6%), applied to the outstanding balance. The period is up to 10 years, including a grace period when the study is being done (6 months to three years).

FONAPRE's procedures for securing a loan and contracting consultants to carry out the planning or feasibility study are modelled on those of the international development banks, and involve formal procedures of pre-qualification, bidding, selection, and negotiation with consultants. FONAPRE has prepared materials and conducted courses for potential borrowers (including municipalities) on how to successfully carry out the steps required to obtain and use the Fund's resources.

#### Technical Agencies

The National Sanitary Works Institute (IEOS), the National Electric Institute (INECEL), and the various functional ministries (public works, health, education, etc.) also interact on a regular basis with the municipalities. The principal point of contact with these agencies is through their regional or provincial-level

offices. They may be called upon to assist with technical studies (sometimes at the municipality's expense), to provide advice on project implementation, to lend equipment, such as a road grader, or to give a technical opinion required by a lending agency) on a project. They of course also interact with the municipalities in the course of carrying out nationally-mandated projects and programs.

### 3.2 Organizations of Municipalities

#### Association of Municipalities

This organization is provided for in the Municipal Code as an entity of assistance and coordination. Since the August 1982 reform of the Code, all municipalities are now automatically members of the Association, and their dues (1% of ordinary income) are withheld from central government transfers. The objectives of the Association, according to the CODE, are to: (a) safeguard municipal autonomy, (b) promote the progress and represent the interests of the municipalities, (c) cooperate with the central government in plans which benefit the municipalities, and (d) participate in international events. The law provides that the seat of the Association shall be in Quito. An Executive Committee is elected by a General Assembly of representatives from all municipalities, and the Association's business is managed by a Secretary General, who has held the position since 1979.

The Association holds an annual congress to discuss common interests of the municipalities. It has prepared analyses and proposals for reform of the Municipal Code for consideration of Congress, prepared special studies on municipal topics, and promoted the attendance of its members at international conferences. The Association names representatives to such national bodies as the directorates of IEOS, the Housing Bank (BEV), BEDE, and the National Transit Board, and is seeking representation on the CONADE board and in the Chamber of Deputies.

The Association currently has a staff of six, three of whom are professionals. Through a recent technical assistance agreement with the International Union of Local Authorities (IULA), based in the Hague, the Association has become the headquarters for a Latin America-Regional Chapter of IULA. This is staffed with two expatriate experts in local administration. They are developing a program of training and technical assistance for local authorities, that will benefit Ecuador as well as other Latin countries.

### Municipal Consortia

There are at least three consortia of municipalities from different regions of the country (Amazon, Manabí, and Loja). The Amazon Consortium was funded 20 years ago, composed of 20 municipalities of the Oriente. It has been active for about a year and a half, maintaining a small staff (five persons) in Quito. The purpose is to bring together the interests of smaller municipalities in dealings with the central government, to share technical assistance resources and information, to track the procedures for specific projects, prepare manuals and propose legal reforms, and provide or locate whatever assistance the member municipalities may need. The Amazon Consortium is funded by member contributions of S/. 7,000 per month.

#### 4. A Day in the Life of a Municipality

Raúl Pérez, chairman of the Municipal Council of Salpuyo, realized that the pounding in his head was not a bad dream, or thunder, but someone beating on the door of his house. He rolled over to see that the clock read 2:30 AM. Throwing a woolen wrap around himself, he stumped downstairs. At the door he found his chief of public works, stamping his feet and swearing. "Mr. Chairman, the water main outside town just burst", he reported.

"So why aren't you rounding up the men to fix it, instead of running to me at this hour?" cursed the chairman, thinking about 15,000 people who would wake to no bath water.

"Because the workers decided to go on strike last night, Raúl, and I don't think I can get anyone else to come out at this hour."

"Have you called the IEOS engineer? It's still legally their system, you know. We haven't taken on the administration just because these kinds of things keep happening. Why can't those guys get the thing to function?"

By this time, the two men were on their way to the kitchen, and Raúl's wife was scooping water from a barrel to make coffee. After an hour of discussion, the Public Works Chief left to roust out the IEOS engineer and whatever workforce he could find to tackle the water problem. Raúl went back to bed, but slept very little, thinking about his plans for the day. It would be feria day, with many people and problems to attend to.

When he reached the office at 8:00, he found nine people waiting in the anteroom, and three of his staff members

already seated around his desk, each with a file tied with string. The chief of finance had ten petty purchase forms to be signed. The legal advisor was ready to review the BEDE loan package (for additional financing to cover the increased costs of electrifying one of the rural poblados), and the assistant engineer (really a crew foreman) had the workers' petition and statement of principles to discuss. Raúl yelled for the council secretary, and asked her who all those people were outside, just as each of his staff members started talking about his individual problem. The secretary went outside to make a list of names and problems as Raúl started signing forms, and asking his foreman what the strike was all about. He told the legal advisor to come back in half an hour. After listening to the foreman for some time, he said he would meet with the workers' representative at noon -- not with the union leader, but with the senior worker. It developed that the group waiting outside was mostly there to complain about the water, and Raúl assured them that the system would be working by noon. As he turned to go back into his office to look at the BEDE papers, the provincial prefect's chief political aide walked in, and insisted that he and Raúl go out for coffee to discuss some party business. In the corner café, Raúl fended off the smart remarks of the market people about the water problem, and took his favorite table to talk politics.

Meanwhile, back at the cluttered municipal office, the financial chief was hunched over a table with his accounting assistant, staring at the formats in the program budgeting manual issued by the national planning office. He had asked his accountant, José, to spread the year's figures over the various spending categories. "I can't explain those damned categories to you, José," said the chief. "I'm a bookkeeper just like you, have been in this office for 15 years, and I've never had anybody give me a decent explanation of what that damned manual is all about. You're a bright lad. Just do the best you can. The CONADE people in Quito will send the budget back anyway, as they have every year, and I suppose we'll hear all about how we've messed things up."

Raúl Páez left the café at mid-morning, and catching a ride on one of the town's two dump trucks (the other having been sent to Ambato for a transmission overhaul), he and the foreman drove out to check progress on the water main. At the site he controlled his anger at the IEOS engineer, who reported that the break would in fact be fixed by noon. "Well, that's certainly an improvement over the last time," grumbled Páez. "It took you almost a week then."

The engineer just turned his back and walked away. He and the chairman had been around too many times on this problem, and he knew he would be leaving on his transfer to Guayaquil next week to help repair flood-damaged water systems in Guayas. He'd let the next fellow struggle with the stubborn chairman.

Raúl drove back through the streets, now crowded with sidewalk stands, peasant women squatting next to their piles of bruised fruit, neatly tied bundles of greens, and coverful knickknacks. When he reached the market square, he smelled the odors of freshly slaughtered livestock, cooking fires in the food stalls, and noted that his tax clerk was walking through the square, collecting a few sucres from each of the vendors. He thought again about his discussion earlier in the week with his council members about raising the market fees, and how the discussion had turned into a heated, and pointless debate about inflation, costs of food in town, and a number of other old points of contention among the members. He decided that this was one fight he would leave alone for a while. He still had to break the news about the cost of the rural cadaster the council had decided to carry out (after much debate). He had received a letter saying that the municipality would have to pay several hundred thousand sucres to obtain help from DINAC, and that work probably would not start for six more months. By then Raúl would be entering his final year as chairman, and he wasn't sure that the cadaster would ever happen.

His lunch meeting with the workers' representative (and the union leader, who happened to appear at the café) went well, after the chairman reminded them both of the law against public employees' strikes, and how the chairman in the next town had broken the union hold on the workforce. As they finished their lunch, including a couple more beers than Raúl usually took at that hour, the pipes of the café started to gurgle as the water from the repaired main began to flow again.

By three o'clock Raúl was sitting down in his office with the legal advisor, who in fact counseled Raúl on planning, dealings with Quito agencies, and even some political matters. By 5:00 they were as satisfied as they could be that the request to BEDE for additional funds was a convincing and complete package. They reviewed the problems with the contractor, with INECEL, the delays in receiving the imported transformers, and the various cost increases each had entailed. It was agreed that the Raúl and the legal man would personally carry the request to the head

of BEDE, just to be sure they has everything right, and would get quick consideration. It seemed to have worked for them the last time.

As they broke up, the council secretary came in to tell Raúl that three council members, the group from the Radical Liberal Democratic Party, wanted to see him in the council's meeting room about a petition they had received to pave the streets in Barrio Mario Jesús. The chairmen knew that this small but growing slum area was a stronghold of the RLDP, and that if he didn't find some money for this, he would lose the votes of the council on the rural cadaster question.

Raúl entered the council room, greeting each councilman warmly, and accepting congratulations for getting the water started again. He read the petition, which was written more as a political tract than a justification for a public works project. "I think I can do something about this," he said. "We have some paving blocks left over from the market repair we did last summer, and they should just about do the job. Will you fellows organize some community work crews to help lay the blocks? We can get the provincial council's grader down here next week to level the streets."

Ramón Torres, the senior member of the group, exploded. "What do you mean, paving blocks? Those people deserve asphalt, and curbs and sidewalks. They're part of this town too, aren't they? And what's this about community work crews. Can't our illustrious public works team get off their behinds and take care of this one?"

Raúl had known it wouldn't be as easy as he had laid it out. It was 9:30 when the meeting finally broke up. The formula for getting paving done in the barrio wasn't much like Raúl's original proposal, but neither had he committed to asphalt. In return for dropping the idea of community work crews, he picked up some support for his tentative agreement with the union man to allow extra time off at Christmas for the public works team.

## B. FACTORS AND TRENDS AFFECTING THE MUNICIPAL ROLE IN DEVELOPMENT

In this section, the judgements of the team of analysts, and the findings of the series of municipal meetings, are assembled around certain major themes related to the current and potential state of municipal participation in Ecuador's development. These themes are (1) the changing financial circumstances of the municipalities, (2) development planning and implementation, (3) delivery of basic services (water, sewage, power, solid waste, markets, etc.), (4) general management and administrative capacity, and (5) institutional linkages between municipalities and local entities, and with national institutions.

It will be noted that not all factors can be clearly identified as having either positive or negative effects. For example, the increased transfers of central funds have raised the municipalities' awareness of the need for management skills (providing a ready audience for training and technical assistance), while at the same time creating increased dependence of central funding. The political freedom allowed since the return to constitutional government has allowed local needs to be more frequently expressed, but has also caused deadlocks within municipal councils.

### 1. Financial Status, Performance, and Prospects

#### 1.1 Income and Revenues

Municipalities in Ecuador have experienced a financial bonanza since the mid-1970s. As the table below shows, between 1975 and 1978, municipal income increased 69 percent. As large as this increase was, it was a bit less than the overall growth of the Ecuadorian public sector. As a result, the municipal share of public sector income fell slightly from 10 percent in 1975 to 9 percent in 1979.

As Raúl walked home past the market square, he saw the town truck being loaded with the last of the market trash. It was a day like most, perhaps a little better than some. He promised himself that he would think long and hard about accepting another political post. His small potato farm and the shoestore would give him enough excitement for some time after this term was over. He might even go back to teaching in the local high school, if they'd have him.

During the four years between 1978 and 1981, municipal income (including local revenues, central government

transfers, and loans) increased each year in amounts roughly equal to the whole of the three years prior. Total public sector income did not increase at the same rate, so that the 181 percent increase in municipal income increased the municipal share of public sector revenues to 12 percent. The aggregate municipal income growth between 1975 and 1981 of 377 percent, when adjusted for population growth and rising prices, works out to be 277 percent, still a substantial amount.

Table 3

SELECTED MEASURES OF MUNICIPAL FINANCES  
ECUADOR 1975, 1979, 1981

	<u>1975</u>	<u>1979</u>	<u>1981</u>
Municipal Income (millions of sucres)	S/2,505.9	S/4,248.8	S/11,953.3
Percent of Total Government Income	10%	9%	12%
Per Capita Income <sup>a</sup>	366.9	549.15	S/ 1,382.8
Constant sucres Per Capita Income (1975 sucres)	S/ 366.9	S/ 434.74	S/ 881.88
Own Source Constant <sup>ab</sup> sucres Per Capita Income	S/ 130.0	S/ 135.4	S/ 167.0
Central Government <sup>c</sup> Transfer as a Percent of Municipal Income	33.8%	43.2%	54%

<sup>a</sup>1975 Calculated using 1974 population, 1978 population estimated on base of straight line interpolation between 1974/1981.

<sup>b</sup>National price index for 1981 estimated by assuming that prices between June 1980 and June 1981 increased at the same rate as between December 1979 and June 1980 (208.54).

<sup>c</sup>Includes petro participation 1975 price index estimated by assuming a price increase between 1975 and 1976. Revenues from unpublished data provided by CONADE. Population and prices; Indice Estadístico

The principal source of increased municipal income was the dramatic growth in the allocation of petroleum participation funds. These central transfers grew gradually from 1975 to 1979 (S/.20 million to 65 million), but in 1980 and 1981 the petro participation transfers to municipalities jumped to S/.1.4 billion and S/2.0 billion respectively. On the other hand, real per capita income raised by the municipalities from their own sources increased by only 20 percent during the 1975 - 1981 period, or about 4 percent per year. Thus, while the volume of resources channelled to the municipalities has increased greatly, the municipalities in the aggregate have not mobilized many additional resources to help increase the level of service they provide, with a few notable exceptions. This brings the result that central government transfers as a percent of local income have grown from 34 percent in 1975 to 54 percent in 1981, a clear measure of increasing dependence, or decreased decentralization.

The S/11.3 billion municipal income from all sources in 1981 can be broken down into three basic categories (based on data from the Controller General, 1981):

Own sources:	20.6 percent
Non-loan external:	53.1 percent
Borrowing:	26.3 percent.

If both loan and non-loan sources are combined, less than 21 percent of total municipal income in 1981 was generated from local tax revenues, service charges, income on assets, etc. It should be noted that future loan repayments of the 26 percent borrowing could come from either own sources or non-loan external transfers. In either case, the current dependency of municipalities on central sources is large, and as we have seen, is increasing.

Whether this dependency is or is not a problem depends on several factors. These include (a) the continuing availability of central government revenues, (b) the relative efficiency of national versus local revenue collection, and (c) one's views on the behavioral virtues of collecting and spending at the some level of government, where people can see locally-determined results and benefits of their taxes.

## 1.2 Expenditures and budgeting

The table below shows the trend from 1975 to 1981 on the expenditure side of the municipal accounts, based on CONADE's financial statistics.

Table 4

### MUNICIPAL EXPENDITURES

1975-1981

(Millions of sucres - rounded)

	<u>1975</u>	<u>1977</u>	<u>1979</u>	<u>1981</u>	<u>Percent Change</u>
Current	1,078	1,557	2,168	3,633	+296%
Capital	958	1,497	1,602	6,186	+546%

As the table shows, capital expenditures have, after a history of being nearly equal to current expenditures, taken a massive leap to be nearly double the amount spent on current operations. This is directly related to the fact that the increased central transfers on the income side which took a significant upswing in 1980, were almost entirely restricted to investment use, as explained above in Section A-3. During the same period, CONADE was closely scrutinizing the current expense budgets, restricting salary increases or staff growth.

Data from the Controller General for 1981 shows that the municipalities budgeted S/14.6 billion for total income and expenditures. As noted above, income amounted to only S/11.3 billion, a 23 percent shortfall, of which 54 percent came from external non-loan sources. On the expenditure side, the shortfall was even greater. Only S/9.3 billion was actually spent, a 37 percent difference between planned and actual performance.

The table below highlights some key differences between planned and actual income and expenditures, using Controller General data.

Table 5

MUNICIPAL BUDGET PERFORMANCE  
1981  
(millions of sucres)

	<u>Planned</u>	<u>Actual</u>	<u>Am't Diff.</u>	<u>% Diff.</u>
<u>Example</u>				
<u>Income</u>				
1. Local Tax Revenues	1,931.2	1,648.7	282.5	-17%
2. Central non- loan Transfers	7,812.1	6,016.8	1,795.3	-30%
<u>Example</u>				
<u>Expenditures</u>				
1. Construc- tion invest.	7,358.9	3,611.1	3,747.8	-103%
2. Salaries & benefits	2,404.7	2,219.5	185.2	-8%

We have selected some example figures in each case (local taxes and central transfers on the income side, and construction investment as a measure of capital spending performance, and salaries as a measure of current expenditures) to try to assess possible reasons for the differences between budgeted finances and actual outcomes. In the area of tax-raising, while the amount raised is low, the difference is less than the overall spread of 23 percent on the income side, suggesting that municipalities' availability to project tax income is better than might be expected. Central transfers, on the other hand, fell 30 percent below estimates. This could represent optimistic projection by the municipal budget-makers, but it could also represent delayed or diminished transfers from FONAPAR, the petroleum fund, or other central sources.

On the expenditure side, clearly the municipalities are better at estimating and paying out such recurrent costs as salaries than they are at projecting the flow of investment funds. As reported elsewhere, there is considerable shared responsibility between local and national authorities for this difference, given the many agencies and complex steps involved in planning and implementing construction projects at the municipal level. It is interesting to note that in those areas where the central government has the greatest involvement --in providing income, and in reviewing and approving investments--the greatest shortfalls occur.

### 1.3 Municipal Revenue

Here, as elsewhere in this report, the term revenue is used as a subset of income, to mean municipal actions to collect taxes, service fees, and improvement levies.

Studies conducted to date suggest that there is good potential to raise the amount of income municipalities can realize from these revenues. This has been shown by positive steps taken in the municipalities of Machala (a coastal cantón of 110,000), Ventanas (a coastal cantón of 59,000) Mera (an Amazon cantón of 4,500) and Salcedo (a sierra cantón of 45,000). In these places, by updating cadasters, building public understanding of the purposes and benefits of increased local revenue, setting service fees at real cost levels, and other measures, revenue increases have started to keep pace with other sources of income.

Our inquiry has found that the greatest obstacles to increasing the amount of municipal income realized from local revenues include:

- (a) the studies and documentation (registers, maps, etc.) that serve as the basis for property taxes, potentially the largest source of local revenue, are outdated, poorly done, or poorly maintained;
- (b) the tax rates, service rates, and improvement levies are also obsolete, or set at levels that do not equate with current costs; and
- (c) tax collection systems, and related records, are handled haphazardly with outdated manual procedures, allowing many tax payers to escape payment.

Aside from these technical problems which are partly due to staffing levels and skills, there is a more basic problem of motivation and political will. With the

dramatic rise in central funding of municipal programs and projects of recent years, there is little incentive to increase taxes. In fact, one part of our analysis suggested that the less local revenue a municipality raises, the more central funds provided. And of course, taxes are never popular, and the municipalities are political institutions. Mayors, council chairpersons, and council members often represent different political parties and factions, and cannot agree on improving tax collection or raising rates. In one town, Esmeraldas, the mayor maintains that the economic depression the town is experiencing makes increased taxation an unfair imposition on the community. In Ambato, following a major urban cadastral study and recommended improved property tax rates and systems, the implementation of the plan was delayed for months in a stalemate between the mayor and the council. The plan finally went into effect, but at 50 percent of the suggested rates.

#### 1.4 Effects and Prospects

Detailed analysis by our team of both the aggregate financial picture, and of a sample of 22 municipalities (small, medium and large, from the three main geographic regions) shows that the trends described above are producing results that raise concerns for the future.

Municipalities are relying more on external sources (both loan and non-loan) for their income. This is less true in the coastal region than in the sierra and the Amazon, and less true of larger municipalities than of medium and small ones but nevertheless, is the general trend. This has various effects. First, the reliance on external, rather than local sources, generally equates with greatly increased investment spending and slower increases in current expenditures. It also means increased debt burden. Municipalities do use some central transfer funds to meet current costs, but this is in contravention to general policy of the Ecuadorian government; which assumes that operating costs will be met from local revenues.

Increased investments, and increased borrowing, imply future demands on municipal own-source income to operate and maintain new installations facilities and services, and to repay loans. This will require increased property taxes, cost-recovery rates for services and other measures which are presently difficult for municipalities to pursue, both technically and politically, as noted earlier. In El Puyo (Pastaza), an Amazon municipality with a dynamic

mayor, and recipient of especially large central transfers, over 20 major public works have been completed in the last three years, including paving and lighting of streets, sports, tourism, and recreation complexes, community centers, improved drainage and water, a market and civic center, a bus terminal, and so forth. El Puyo, like other places of its size, will not have to worry about the future costs of this building program as long as central transfers and loans keep flowing from Quito. But the prospects for this, given Ecuador's economic and financial straits, are poor. Unless local revenues grow to offset dealing FONAPAR and petro funds, the debt-bearing capacity of municipalities will diminish. Investment programs will have to be cut, and depending on how serious the squeeze becomes, facilities and services may have to be cut back or shut down. The choice for the future becomes quite simple and stark--either raise revenues locally, or cut services.

Another effect of the changing financial circumstances of municipalities, particularly the imbalance between rapidly rising investment and slowly rising current expenditures, is that there is simply not enough staff, well enough prepared and compensated, to perform all the new functions required. This topic is to be explored under the following topics, but it is a recurring theme, suggested by the financial data on budget performance, and directly and forcefully discussed by every municipal administrator we interviewed or surveyed. Examples abound of equipment for which there are not operators or mechanics, financial reporting requirements which cannot be fulfilled for lack of staff, and the like. There will have to be increased investment in human resources to complement the drive for physical resources.

Borrowing by municipalities from official agencies such as BEDE and FONAPRE does not at present represent a financial difficulty for municipalities. The terms of the loans are reasonable, the agencies carefully examine the financial status of the cantón before making a loan, and they are willing to refinance or modify terms if a good case is made by the municipality. This is not the case when a municipality borrows funds from a foreign private bank, as did Ambato for a traffic overpass project. Given the city's revenue problems and the country's foreign exchange problems, it will probably require action by the central government to clear the debt.

However, in the case of BEDE lending, there are some aspects that will deserve careful attention in the future.

BEDE presently has little involvement in assuring that potential revenue-producing projects in fact pay for themselves, including debt service as well as operations and maintenance. This may leave municipalities with uneconomic projects which have to be operated and amortized out of other sources, as noted above. BEDE may want to consider conditions on its loans, so that municipalities are required to set adequate service fees for the use of BEDE-funded facilities.

BEDE's loans are now guaranteed by FONAPAR accounts. Payments on loans are withheld for BEDE by the Ministry of Finance. This places BEDE in a risk-free position as long as FONAPAR, which is in turn derived from national taxes, continues strong. This is uncertain, given current economic prospects, and may be an incentive for BEDE to be more diligent in assuring the self-financing nature of municipal projects.

## 2. Development Planning and Implementation

### 2.1 Role of the Municipality in Development

As defined by the Municipal Code, and summarized in Section A-1 of the study, the municipal role in development is currently defined in terms of providing social infrastructure for the urban areas, although municipal jurisdictions include significant rural populations in nearly all cases. The present focus is depicted in Exhibit 1 on the following page. The needs for basic services, such as water/sewer, electricity, and the like, are serious in nearly all municipalities, as suggested by the typology in Section A-2.2. Systems for the older central towns are in need of renewal, and in many of the newer marginal urban settlements or built-up rural areas, these facilities range between rudimentary and non-existent.

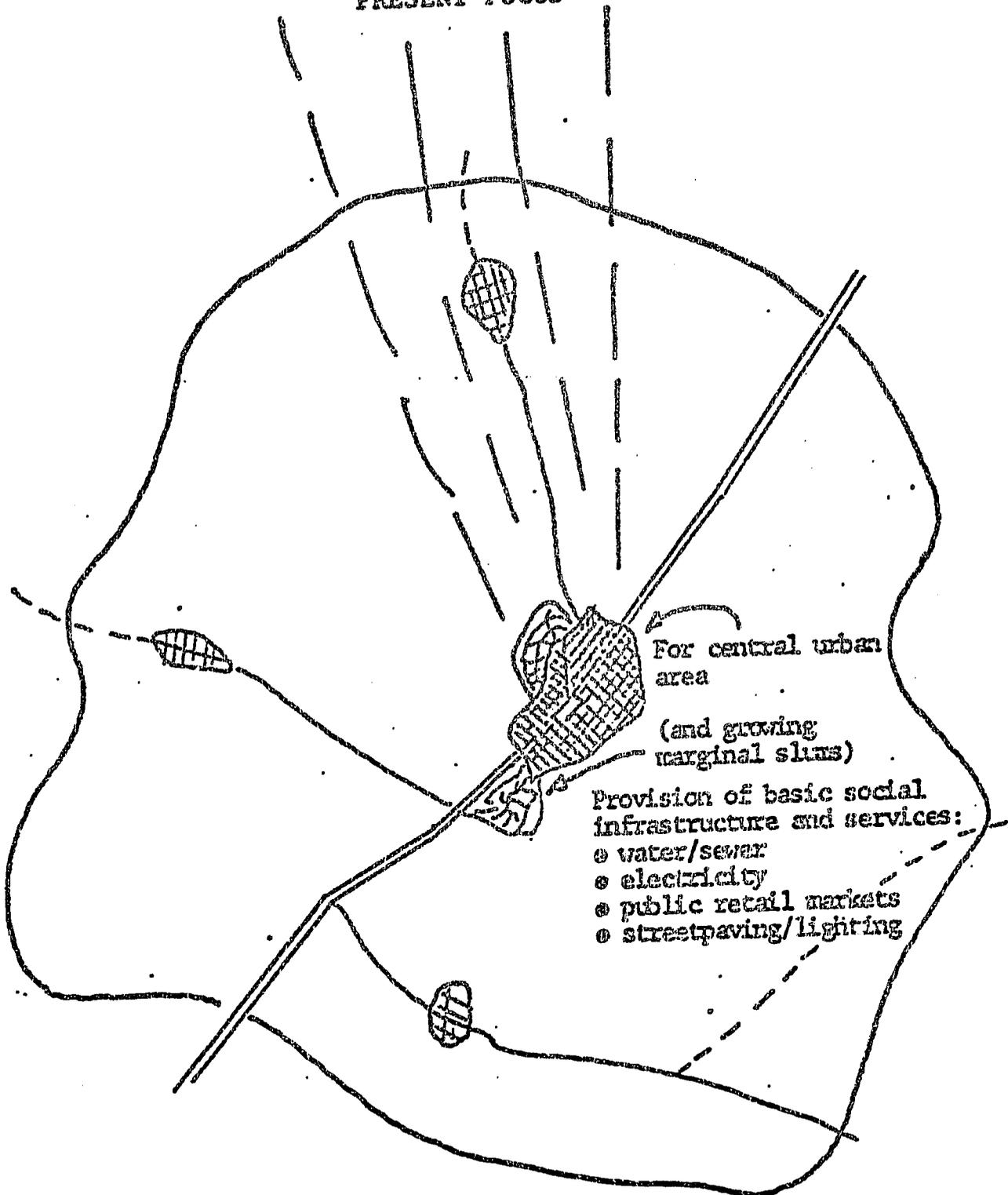
From the viewpoint of development technicians in Quito, the municipal role is to accept central resources for investment in projects identified as national priorities, with a rough division of labor with the Provincial Councils in this page goes Exhibit 1 providing for the rural areas--especially schools, health facilities, and feeder roads--and the municipalities attending to the urban areas.

To date, the municipalities have not been expected to take a significant role in providing economic infrastructure (industrial sites, wholesale markets, and the like). This has been the responsibility of national

Exhibit 1

ECUADORIAN MUNICIPALITIES:

PRESENT FOCUS



agencies or the private sector. Housing development has also been left to private individuals or organizations, with government incentives geared mainly to middle and upper-class needs until recently.

Municipal leaders traditionally have been elected or selected from among the business and professional classes. These town-based people saw the focus of municipal action as being to assure that public offices were well-housed, that commercial areas were policed, drained, and kept clean, and traffic problems resolved. This concept of municipal development has its roots deep in Latin American, and even Spanish, history.

There are signs that this concept is changing in Ecuador, as it is elsewhere in Latin America. Council members and mayors increasingly come from working-class, organized groups, such as teachers and drivers. Mayors and council presidents from agricultural backgrounds now hold office.

Through them, and from the people directly, are coming demands for extending municipal services both geographically and functionally, to attend to the poorer areas, to respond more to rural needs, to attend to problems of irrigation, marketing, health youth and recreation--programs assumed to be central government responsibilities, but which do not reach effectively all parts of the country.

With the expanded financial resources available to municipalities, expectations have been raised that local government will respond more to local needs, including expansion of basic services, but also advocating or directly pursuing economic growth opportunities. In Esmeraldas, where port and refinery development produced little of the expected employment (but a large inpouring of job-seekers), development of light industry, or reestablishment of banana production, to create jobs and occupy the port, are of higher interest. In El Puyo, which "exports" lumber, hides and field crops to be processed in the sierra, there is a desire to create local processing enterprises to capture the value-added. While many mayors and council presidents appreciate the need to raise local taxes, they also want to link it to improving the area's economy, and thereby expanding the tax base.

## 2.2 National Efforts in Local Planning

As mentioned briefly in Section A-2, the urban structure of Ecuador is changing, with increased population pressures on the smaller cities and towns.

As these changes have become more apparent, a series of studies of the development problems of secondary cities, market towns, and other growth poles (like ports) have been done, principally by the National Development Council (CONADE), formerly the National Planning and Coordination Council (JUNAPLA). With participation of advisors from the OAS and the UNDP, a number of analyses were done in 1976-77, and again in 1979, which focused on a wide range of issues related to local development outside Quito and Guayaquil. The earlier series were prepared as part of an effort called "Bases for the Establishment of a National System of Local Development", others were part of a microregional planning activity, and other studies were done in preparation for an urban strategy for the 1980-1984 national development plan.

The urban hierarchy was studied, applying regional analysis techniques. Agricultural marketing interactions were studied. Issues of local government finance and administrative capacity were analyzed. Socio-economic research was done on the urban poor in a number of cities. Shortfalls in housing supply, availability of basic services like potable water, electric power, schools and health facilities were identified for most of the towns.

The 1980-84 national plan distilled the following from this comprehensive study:

- (a) Need for better communication between regions and provinces
- (b) Need to reduce the concentrating power of some cities
- (c) Need to articulate the roles and production functions among the country's rural areas
- (d) Need to articulate the rural and urban functions, via the provision of services, articulation between agricultural production and industrial processing, and improvements in welfare.
- (e) Need to articulate the urban centers, to insure the adequate provision of services around and in each

center, and to reduce the increasing primacy of Quito and Guayaquil.

- (f) Need to articulate the use of urban lands, so as to put into effect a low-income housing policy, an industrial development function, better provision of services, marketing, etc.

To the evident disappointment of the technicians who assembled the material at great cost and personal dedication, the current published national plan offers little in the way of action plans and resources to address these problems. What remains, however, is a valuable body of information and ideas for use when the policy climate is more receptive, and a group of people, most of them still working in CONADE, who have direct experience with the analysis, and an active interest in its eventual application.

During the 1970s CONADE sponsored, or directly implemented a number of local development plans. Most of them emphasize physical planning (land use, zoning, traffic patterns). Review of a sample of these shows that they are weighty, often very academic, and do not show much evidence of participation of local leaders and interest groups. Social and economic analysis is minimal, the main focus being on establishing guidelines for future construction.

Ecuador lags behind other Latin American countries in the application of simplified technology to the solution of urban problems. Technical standards for public works and private construction remain high. This has the following kinds of effects:

- (a) Land-use plans provide for unnecessarily large lots and wide streets which are more difficult and costly to supply with water, sewer, and electric connections;
- (b) Services are provided at a maximum level (water piped to each home, daily trash collection, sodium street lamps on reinforced concrete poles, streets paved with asphalt rather than blocks or stones);
- (c) Housing standards are set at levels which prohibit the use of local materials and simple techniques which owners could practice to upgrade or replace their dwellings; and

- (d) Construction designs and practices appropriate to one part of the country -- often the Sierra-- are recommended by experts without adaptation to different regions with their distinctive climates, materials, and conditions.

All of this means that if the experts' plans and standards are adhered to by local authorities, the investment funds cover less area and fewer people, have less effect on local economies (employment of local labor and materials), and seldom reach to the people most in need. Municipal administrators who want to experiment with lower-cost, simplified methods are denied approval by technical agencies or experts, or opposed by town leaders who want only the latest and the "best" technology.

### 2.3 Local Planning of Development

Planning units are scarce in Ecuadorian municipalities. The inaugural meeting of the Association of Municipal Planners, held last spring in Ambato, brought together ten of the fourteen fulltime municipal planners in the country, all located in provincial capitals. In smaller places like Salcedo and El Puyo, the planning function is located in the public works department. The staff obeys the priorities of that unit, largely focussed on street paving and repair, and tries to carry out the provisions of a land use and zoning plan, if one has been done. These plans provide some guidelines for future investment, but don't really help local officials to face questions of overall development of the cantón. The maps are usually posted on the municipal walls to be used for issuing building permits and guiding land development in the central town, but it is difficult to determine whether they influence or inform the investment and budget decisions of the municipalities.

Rural development planning, to the extent that it is done by municipalities rather than the Ministry of Agriculture or provincial officials, is really project-by-project responses to demands from the rural parishes for basic services like water supply and electricity. Since there is no formal representation of rural parish leaders on the municipal councils, municipal planning tends to be focused on the capital town and its immediate environs.

Rural-urban planning, or microregional planning, has been of growing interest at the national level since the

late 70s. The interest in this that is now being expressed by mayors and council chairmen, arises in part because of the pressures they are facing from in-migration, and because of urgings of national planners and technical agencies. A UNDP project in this area was cancelled when a number of local plans were in draft form. The studies have not been shared with local people or completed. Municipalities find that their project-by-project plans are being questioned by higher levels in CONADE and elsewhere, who require that projects be presented within some kind of a context or scheme of priorities and linkages.

There is presently no formal means for developing planning skills at the municipal level, other than by hiring young graduates of one of the architecture/urbanism faculties.

Development planning also has a political dimension. Long-range, comprehensive development plans may be seen as threatening to local politicians, who fear that a plan will take away their discretion to respond to special needs of communities. They gain credit by providing them with small, but visible projects like lighting a street, installing sidewalks, or putting in a drain pipe. Or they may want to care of their own special interests through the erection of monuments of one kind or another. If a plan is too prescriptive, it may be in danger of remaining on the shelf as another study, or never being funded for lack of council approval.

As in the case of improving local revenues, the effort to improve local planning will require elements of community education and participation in decisions, and perhaps a simplification of methodology.

#### 2.4 Project Planning and Execution

Project planning and execution by Ecuadorian municipalities is inaccurate, and slow. It is also plagued by conflicts delays, and cost overruns, as it is in the most well-managed countries. These problems are caused by a number of factors, some of them occurring at the municipal level, and others at the intermediate and national levels.

Most municipalities lack fulltime staff with skills in planning, as we have observed. The technical and financial studies required by funding agencies are rigorous, and must pass review by a number of central entities. The result is

that most municipalities contract for technical studies with entities such as IEOS or INECEL (who may do the work, but more likely will contract with a consultant), or directly with consultants, professors, or graduate students. Frequently the municipality finds out during construction that, due to its own lack of expertise in reviewing the contractor's work, the study was not thorough or accurate, or the design was faulty. Future operating and maintenance systems and costs may not have been spelled out.

Once the documentation for a project to be funded out of central transfers or a BEDE loan has been assembled, it must go through the many reviews and approvals described in Section A-3. In the ideal, this series of procedures could be complete in a matter of weeks, but it generally takes months. BEDE, for example, has over 400 projects in the process of revised planning, review, or pending with other central agencies.

Once the approvals are obtained, the municipality may carry out the project by direct contract, or by having the technical agency do the contracting and oversee the work. As municipal projects have become more numerous and complex, this is straining their limited staff and technical ability. Smaller municipalities may receive no responses to an invitation for bids on construction. They then have to repeat the process.

Once the construction begins, the municipality must supervise the work, check and pass along the invoices to obtain progress payments, and keep the accounts according to required accounting standards. If payments from the central funding agency are not provided promptly, work may have to be stopped if the municipality doesn't have other funds to keep the contractor going. The project may also be affected by shortages of materials or equipment, delays by the contractor, labor problems, or bad weather. If the implementation has been undertaken by an agency such as IEOS, whose provincial staffs are underpaid, spread too thin, and who have little operating authority, the municipality's problems and project delays, may be compounded.

Many lessons have been learned, as recounted to us by municipal authorities. As the pace of investment has increased, local officials have learned to appreciate the kinds of skills they need on their own staffs, how to work with (or around) central agencies, how to supervise

consultants to assure quality work, and how to manage funds. Mistakes have been made, sometimes costly ones, and many projects stand incomplete, or in need of redesign. Municipalities are often criticized for their inability to utilize in a timely and effective manner the investment funds available to them, but the history of recent years shows perhaps that they have done remarkably well, given their limited human resources, the complexities involved, and an almost complete lack of training or technical assistance. The experience has certainly raised consciousness at local provincial, and national levels about the need for training and technical assistance, and a growing awareness of the need for simplification or reduction of the many, often duplicative review and approval steps. Provincial-level offices of national agencies may have to be strengthened, including increased authority for purchasing, in order to be more responsive to municipal needs.

### 3. Delivery of Basic Services

This refers to the on going financing, operation, and maintenance of water systems, solid waste systems, electrical systems (where they are not part of the national network), slaughterhouses, and of recreation or community centers or other facilities, once the investment construction phase has passed. Nearly all of these services are operated on a subsidized basis. The 13 municipal enterprises which are run as separate entities, and whose financial performance is reported by the Controller General, show the same outcome as with the municipalities as a whole. Both income and expenditures (particularly on capital expenditures) are overestimated. There is a heavy dependence on central or local transfers.

Services which are managed within the municipality generally have no basis for estimating the true cost (operation, maintenance, debt servicing, losses due to unauthorized use) of delivering the service. Water or other services rates are set arbitrarily, and generally at a politically acceptable low level, if they are charged for at all. In many municipalities, users of services are expected to come to the town hall to voluntarily make their payments. If a property changes owners, the new occupants may use the service for months before the municipality takes note and requests payment. Cost estimates are difficult to obtain because different services (trash, street maintenance or paving) may use the same vehicles, equipment, and workforce in many small towns.

In some municipalities, officials are taking steps to change the expectation of free or nearly free services, and along with community education, are asking for assistance in doing cost studies to determine what real rates should be. They are seeking organizational studies to determine what personnel, equipment, and backup services (administrative, laboratories, etc.) are needed to be able to deliver quality service on a cost-recovery basis. At present, municipalities are not sure which agency or other organization can provide this kind of assistance.

#### 4. Management and Administrative Capacity

A municipality is like any other organization--it must have goals, means of reaching those goals, function within a certain style and method of leadership, have explicit or implicit standards of performance, struggle with coordination and communication problems, and the rest. Administrative tasks may be done within established routines, or on a freelance basis by each functionary or department.

In our brief visits, we cannot claim to have studied the management of selected municipalities in depth. What follows are impressions gained from observation of interactions among staffs, comments made by employees and citizens, and examination of records.

Municipalities are, on the whole, highly centralized around the mayor or council president. People who have business with the municipality go first to the office of the top person, and then are referred on to the appropriate unit. In larger towns, where mayors are involved in many political and ceremonial activities outside the office, business often is delayed. All matters involving personnel, and most involving expenditures of funds, require the mayor or council president's signature. Whether this is by law, by custom, or because of personal style, is not clear. The management practice, however, is highly controlling, rather than shared or collaborative.

Likewise, it appears that communication patterns are more often to and from the mayor to different units, rather than across units. Coordination among such interrelated functions as financial planning, development plans, tax collections, insurance of building permits is done through the mayor, if at all. Municipal personnel often expressed ignorance of what other units were doing, even if it affected their work or future plans. In imitation of this

to management, at the top level, unit heads tend to communicate downwards, to keep information to themselves, and to closely control the work of their employees.

Municipal personnel are expected to either know what is needed before they are hired, or learn it on the job. In a few cases, as limited opportunities are becoming available, staff members are sent for training outside the municipality. In El Puyo, the mayor has urged the Consortium of Amazon Municipalities to set up training courses, and has sent mechanics for advanced training, accountants to Controller General courses, and so forth. In Ambato, the personnel director is implanting ideas of teamwork within and among departments, and hopes to have a training person added to his department. These are the barest beginnings of improved personnel management.

Not surprisingly, even in the larger municipalities, records are maintained by hand, whether of accounts, property, taxes, service rates, personnel records, etc. Files and records are maintained on open shelves, sometimes for decades.

Until recently, the number of employees and workers, and their salary levels, were closely controlled by CONADE as part of its oversight of municipal adherence to national personnel laws. Now that more freedom has been permitted in this area, some municipalities are moving to raise salaries to attract better-trained, fulltime personnel (because of low pay, many employees had to have more than one job). Smaller municipalities are giving some of the larger raises, claiming that they need to pay more to compensate people coming from larger towns where there are more comforts, better schools, entertainment, and the like.

## 5. Institutional Linkages

As we have seen, the municipalities' decisions and actions are heavily influenced by local forces, and by a host of national institutions. Section A-3 described the formal roles and functions of a number of the institutions affecting municipal administration. Here, we are concerned with how the linkages work out in practice, and the trends and changes that are occurring.

### 5.1 Local Institutional Relationships

The comments which follow, about municipal relationships with labor unions, private sector groups,

political parties, provincial governments and regional development entities, are impressions deserving further inquiry.

Labor unions are showing strength at the local level. First, within the municipalities themselves, in many instances the blue-collar labor force works under a union contract. As reported by several local officials, this has raised the compensation (salary and benefits combined) of street cleaners, water supply workers, etc. to levels equal to or above the white-collar workforce, whose compensation has been controlled by national standards.

Two of the most widespread unions in Ecuador are the teachers' union (UNE) and the National Federation of Professional Drivers (FNChPE). Notably, teachers and drivers (of cabs, buses, and trucks) are predominant on the municipal councils, having replaced many of the businessmen, lawyers, architects and engineers who historically made up the council memberships. The effects of this change would be worth further investigation, but our impression is that possibly a more populist view of the municipal role is being represented in municipal decisions, while at the same time, the longer-range, technical view of the professionals of the past has been sacrificed.

The Chamber of Commerce in Esmeraldas is working closely with the municipality in a campaign to bring more business and employment to the city, and more activity to the new, underutilized port. In Ambato, which has a long-underutilized industrial park, there is an expressed communality of interest to activate the park, bringing in more plants, as many of the Chamber of Industry members are former council members. As, in the past, the municipalities were often regarded as serving business interests first (paving and lighting commercial districts etc.), and social needs later, it would be worthwhile to follow developments in a few municipalities to see how this changes, and how business-municipal relations evolve.

Political parties (or movements) have flourished since 1979, with about 15 operating nationally or regionally at any given time, as alliances are made, or groups split into factions. Under the reformed Municipal Code, all candidates or office-holders for municipal councils must be members of a recognized party. Given the legal requirement, and the number of parties, it often occurs that councils are made up of members with disparate

loyalties and interests, which may explain in part the mayor-council and intra-council conflicts and stalemates reported in interviews and the press.

These problems may be more acute at the moment, given the upcoming election, and sharply differing viewpoints about the country's serious economic squeeze and how it should be handled. Given the relative youth of democratic government in Ecuador, it is probably too early to draw conclusions about the kinds of effects that party activism may be having at the local level. We can say that only one municipality has reached paralysis requiring intervention by the Ministry of Government, and that most appear to be carrying on their business of budgeting and spending money, with operating majorities of municipal councils.

A general observation about municipal relations with provincial councils is that there appears to be some duplication of effort, particularly in meeting rural needs, and that the legally-mandated role of the provinces to "coordinate municipal actions" is rarely realized. Nor does it appear that provincial prefects and councils fulfill a role of coordinating the work of national agencies (whose offices are located in each provincial capital) to the benefit of the provincial or municipal interests. Some of this is ascribed to party politics which interfere with mayor-prefect cooperation, and to the limited authority of provincial heads of national agency offices. Municipal officials most frequently find that they must seek decisions or assistance from national agency offices in Quito, rather than relying on provincial-level offices.

Regional development entities in Ecuador, like those elsewhere in Latin America, tend to work alongside, rather than through or with municipalities. They are generally focussed on large-scale efforts (watershed management, or improving road networks) which cut across municipal boundaries, or are focussed on rural needs. CREA cites plans to work more closely with the municipalities in its area to improve their administrative and management capacities, and to work more closely with BEDE and FONAPRE's municipal programs. Given that the regional entities carry out projects which bring positive economic benefits to the municipalities' areas of jurisdiction, they generally speak positively about those agencies. Until now, however, it doesn't appear that the regional development agencies are working purpose fully to increase

the municipalities' capacity to plan and execute development activities themselves.

## 5.2 Obstacles to Municipal Development

The principal obstacles to strengthening the development role of municipalities in Ecuador take several forms--attitudinal, behavioral, procedural, and legal. These obstacles are not static, but changing, nor are they totally blocking many of the positive things that are happening. They must be recognized as part of the real background, however, and approached in a purposeful, steady way over a long-term time frame.

Centralismo, Expertismo, and lack of confidence are themes of attitude and style in Ecuadorian public administration with emerge repeatedly in conversations, behavior, and reports of behavior at all levels. They are obstacles to municipal management.

Centralismo, as perceived by municipal administrators, is that set of attitudes that is summed up as "Quito is always right", and if it wasn't approved here, it can't go forward. It also seems to take the form, in conversations with central officials, of an unwillingness to allow local authorities to make their own mistakes, take the consequences, and learn from them--in other words, act like adults. Pre-audit is the prevailing mode, trying to prevent trouble (misguided priorities, misspent money, badly drawn contracts) before it happens. The problem with this, aside from the delays and conflicts it creates in local administration, is that the central officials, by their own admission, doesn't have the staff, the local knowledge, or the time and money to control effectively, thoroughly, and wisely from the center.

Centralismo, as symbolized by the S/.50,000 limit on spending authority of the chief regional IEOS engineer, also hampers the ability of the field staffs of the technical ministries. Even when relations are good, and the spirit of cooperation and support for municipal efforts is present, the technician in the provinces cannot act. We are told that this is slowly changing, and that a few agencies are truly decentralizing authority.

Expertismo is the dedication to textbook solutions, high (often imported) standards, and unwillingness to listen to informed local opinion, adapt to local traditions and materials, and search for practical solutions.

Engineering of public works in the coastal area using methods appropriate to the sierra was one example. Another was building school houses in the Oriente using highlands materials and designs. Mayors are local people with access to local wisdom of which they are proud. They want to see local materials and labor employed, and they want their investment funds to go as far as possible.

Lack of confidence was a term used by Ecuadorians to explain a number of behaviors. It refers to (a) lack of confidence, faith, or trust in one's fellow man's abilities or honesty, and (b) lack of confidence in one's own abilities to find solutions, drop the facade of expertismo, and take risks with others. This was expressed to throw light on the difficulties observed in generating teamwork, collaboration, or information-sharing among agencies, between levels of government, and within institutions. Mayor-council conflicts were deep in each community we visited. Provincial-municipal relations were distant at best in each place. Central-local difficulties are apparent. Studies of local conditions done by one central agency, which would benefit another, are not shared easily if at all. Offices within the same municipality don't exchange information that would make the place work better. The idea of sharing credit for an achievement seems to be hard to accept.

These points are cited to reveal an underlying pattern of human behavior which impacts on the ability to plan across sectors, the potential for technicians and politicians to work together, and which seems to throw some light on the issue of getting things done. It also affects the matter of how quickly truly decentralized development can take place. People can learn to trust themselves and each other more (outside the traditional ring of confianza of the family, compadres, and political groups), through certain kinds of training activities focussed on task accomplishment. If a consistent philosophy of training, which emphasizes confidence-building, can be woven through the institutional development process in local development here, it may help over time to chip away at the centralismo and the expertismo.

A good way to get an interview with a mayor or chairman off to a lively start is to ask him about his opinion of, and experience with, the autonomy conferred on municipal government by the Municipal Code. The law contains

specific prohibitions against interference in municipal affairs by state agencies, including:

- (a) removal of any municipal official;
- (b) overriding, changing, or suspending local ordinances, regulations, resolutions, or agreements;
- (c) impeding the execution of projects or plans of local authorities;
- (d) depriving the municipality of any of its income without replacing it with another source of equal amount; and
- (e) depriving the municipality of its property without its agreement and appropriate payment.

There are additional provisions of Chapter III, Article 17, but these capture the main idea. In the municipalities' key functions of revenue-raising, operation of programs, projects and property, and their right to attend to their own business with their staff, they are nominally given protection against interference by other government authorities.

In practice, mayors and council chairmen perceive their autonomy as extremely limited. Additionally, in 1981, a national-level dispute arose between the Association of Municipalities and the Controller General regarding the question of whether elected municipal officials (mayors, chairmen, and council members) are "public servants" subject to fines and even removal. This arose in the context of the Controller General's investigation of irregularities in municipal contracting in Guayaquil, and his imposition of fines on elected officials of that city. The Controller General recommended that the Guayaquil mayor and one of the council members be removed from office.

The problem of infringement on municipal autonomy is really more subtle and pervasive than the Guayaquil case which mobilized the Mayor of Quito in his role as President of the Association. It intrudes into the everyday business of local budgeting, and financial flows, project planning and execution, staffing and technical capacity. It is done in the name of national development planning in most cases, but results from a number of other factors as well including the attitudes discussed above.

The most frequently mentioned and resented instruction is the control exercised by the public finance branch of CONADE in its exercise of a dictamen on all municipal budget. A dictamen is a judgement, an opinion, or advice, and in this instance the original intent was to review

municipal financial, especially investment, plans to see that they conformed in direction to those of the national development plan. Presumably the dictamen would guide the municipality in terms of its major projects, particularly those being financed out of loans or transferred national funds.

In practice, CONADE exercises a veto/approval function over all aspects of municipal budgets, including purely local investments using local funds (a new cemetery for Ambato, for instance), and has exercised oversight of the civil service and national budget law, questioning salaries and staffing levels during a time when all municipalities saw themselves (and were criticized) as being short-staffed and lacking talent. As noted, CONADE can, by its questioning, delay execution of the budget, and can even immobilize central transfers.

Local officials contacted during this study understood in theory CONADE's role in following up the priorities of the national plan, or in maintaining some oversight of uses of national funds. Their irritation was aroused by what they saw as (a) interference in purely local matters, (b) unwillingness or inability of CONADE staff to travel to the local areas and understand the reasons behind plans and budgets, and (c) control and criticisms, rather than help in producing better plans and budgets.

The actions of national technical agencies, particularly IEOS and INECEL, but also DINAC, were cited as interfering with the attempts of local officials to solve their problems in a timely manner. Examples cited were:

- (a) Technical studies, paid for by municipalities to be prepared or supervised by the technical agencies, were overdue in delivery, or turned out to be badly done (incomplete, technically inaccurate);
- (b) Studies done independently by municipalities' own consultants were regarded by the technical agencies as invasion of their area of authority, and their approval (required to obtain BEDE financing, for example) was withheld or delayed;
- (c) Parts of projects being executed by technical agencies with municipal funds (loans, central transfers, or others) were left incomplete.

The municipal officials' reaction is that often the agencies neither help them get the job done, nor get out of the way so that the municipalities can do it themselves.

The effect of this is that municipal administrators find their margin for initiative (one way of measuring autonomy) very restricted. In many ways they act as, and are regulated as though they were, extensions of central government authority to the local level.

On the following page is a graphic (Exhibit 2) showing the various national agencies's formal interactions with the major functions of municipal government. It is a small wonder that the municipalities find Quito confusing, and the central officials regard the municipalities as chaotic.

### 5.3 Support for Municipal Development

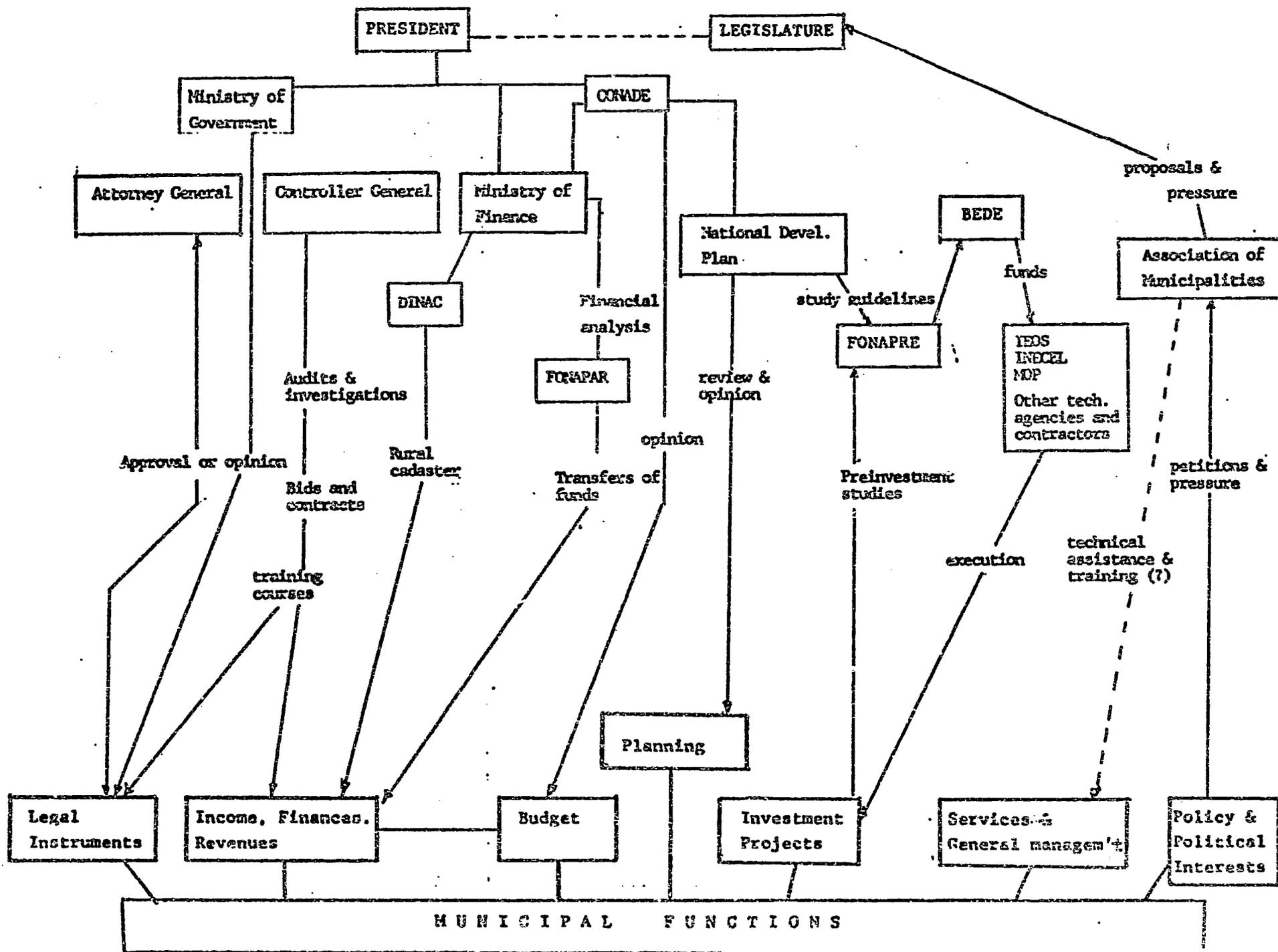
Each of the agencies cited in Section A-3 has an existing or potential role to play in the strengthening of municipal autonomy and effectiveness. Each of them, in turn, brings to the problem a special set of talents, and well as some notable deficiencies. Nearly all are understaffed for the magnitude of work that has to be done. The CONADE units, for example, whether in finance or planning, each have a handful of people, mostly desk-bound in Quito, with no regional or provincial units. The Association of Municipalities' two technical assistance staff members (the Ecuadorian counterparts) are acting not only as members of a Latin America regional project, but are expected to do studies, provide assistance, and respond to the agenda of the Ecuadorian association.

On the following page is a chart of the organizations which currently or potentially could provide assistance to municipal development. Among many, such as BEDE, BEV, INCAE, and FONAPRE, the need and the opportunity to become involved in assisting municipalities is a recent interest.

This gives them an advantage, in terms of starting out with a relatively clean slate. Others, like CONADE, the Controller General, or the Ministry of Finance, have established relationships, which are permeated with attitudes of centralismo, expertismo, and control.

The existing nature of these relationships, agency by agency, is summarized in the following chart. The discussion which follows is focussed on the functional needs of the municipalities, and the degree to which central agencies and other organizations can be expected to respond to those needs.

ECUADORIAN SYSTEM OF RELATIONS BETWEEN NATIONAL AND MUNICIPAL ENTITIES



### Financial Administration

The CONADE staff takes their responsibility as overseers of national development priorities very seriously. At the same time, they support the idea of providing technical assistance to municipalities, and in fact try to do some of it themselves, generally in the central office when municipal administrators come to them. They would like to give courses in budget preparation, and travel out, but lack the money, staff time and number for that. They feel that there should be a leading role for CONADE in any technical assistance program that is started. This is because CONADE's staff has years of experience and "knows the municipalities' problems better than they do themselves." It will take a significant change in mind-set, resources, and role for this office to take on a supportive assistance role, given the history and attitude of control of CONADE.

The courses provided by the Controller General's office have been attended by municipal financial staffs, and they report that these were helpful to them. The training unit plans 45 courses this year for public sector people, in the areas of basic laws, accounting, auditing, and project controls.

The Institute of Administrative Studies (IEA) is connected with the Faculty of Administration of the Central University. The IEA has a fulltime staff of 10-12 professors and four students, plus support staff. They have experience in setting up training courses and technical assistance in administrative matters, working closely with client agencies. They have particular experience in accounting, budgeting, and taxation.

EXHIBIT 3

INSTITUTIONS RELATED TO  
MUNICIPAL ADMINISTRATION

<u>Institution</u>	<u>Departments(s)</u>	<u>Brief description of Relationship to Municipalities</u>	<u>Resources</u>	<u>Observations Attitudes</u>
1. CONADE.	Regional & Urban Studies Div. Public Fiscal Policy & Coordination Division	CONADE, as development planning and coordination agency, establishes priorities for projects, reviews and opinions on municipal budgets and their changes and gives limited technical assistance.	8 professionals for budget review, plus technicians in other divisions.	Municipalities consider CONADE budget review a necessary evil, and some see it as undercutting cial autonomy.
2. Ministry of Government	Sectional Affairs Directorate	Coordinates relations between munic. councils and central government. Approves or rejects transfers of assets, acts as judge in expropriations, approves creation of parishes, and approves tariffs and taxes.	10 employees, 2 professional. Uses power to intervene in cases of conflict.	Municipalities don't mention. Given limited staff exercises duties routinely.
3. Ministry of Finance	Disbursement Section	Approves and supervises the transfers of funds from central government to municipalities (FUNAPAR, Petroleum Fund two percent of government budget, etc.)	Considerable influence over funds flow	Ministry believes it should exercise more control over municipalities, while they see its actions as interference with autonomy.
4. Controller General	Various, plus Training Dept.	Undertakes special, operations and financial audits of municipalities based on budgets passed by CONADE. Provides technical courses in accounting and auditing.	Judges cases involving mismanagement of funds. Strong training operation.	Commands respect, and some fear among municipalities.
5. Ecuadorian Development Bank (BDEE)	Various - new technical asst. unit	Makes loans to municipalities (among other entities), receiving payments through FUNAPAR	Excess of uncommitted funds. Sufficient personnel.	Commands respect, and some fear, among municipalities.

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INSTITUTIONS RELATED TO  
MUNICIPAL ADMINISTRATION

<u>Institution</u>	<u>Departments(s)</u>	<u>Brief description of Relationship to Municipalities</u>	<u>Resources</u>	<u>Observations Attitudes</u>
6. National Preinvestment Fund (FONAPRE)	Urban Development Programming Coord. Financial Admin.	Provides loans and technical assistance for preinvestment studies.	Small, high-quality staff, including ex-municipalities	Municipalities finds its procedures demanding.
7. National Cadaster Directorate DINFC	-----	Carried out cadasters for rural areas of municipalities, and prepares receipts.	Limited staff, equipment and funds. Methods could be improved.	Municipalities satisfied with services, though some find them expensive.
8. Association of Municipalities.	Technical Assistance Unit	Represents interests of municipalities before national bodies, holds an annual assembly. Recently started a project with IULA for a center for Latin America in assistance to local governments.	Three professionals. Receives .1 percent of municipal income as dues.	Many municipalities know it only through annual assemblies. Some believe it serves only provincial capitals needs. Association seeking to broaden role.
9. Consortio of Municipalities		Represents interests of groups of municipalities. Amazon group active, with office in Quito to follow bureaucratic procedures for municipalities, provide information, etc.	Amazon group: 5 employees, 2 professional, and S/.7000 per month per municipality	Seeking to expand role into organizing training, technical assistance.
10. National Institute of Sanitary Work		By law charged with authorizing all sanitary works. Up to now has planned built, supervised, and managed projects. Seeking to limit its role.	Has some funds, and power of approval of projects.	Widespread bad reputation with municipalities, for whom water/sewer is one of top priorities.

INSTITUTIONS RELATED TO  
MUNICIPAL ADMINISTRATION

<u>Institution</u>	<u>Departments(s)</u>	<u>Brief description of Relationship to Municipalities</u>	<u>Resources</u>	<u>Observations Attitudes</u>
11. Regional Development Entities		There are five in different regions - of the country, responding to different ministries. Provide some assistance, and do plans and projects of regional nature. May duplicate some municipal functions.	Some have good technical staffs and ample central government funds.	Municipalities see them as useful resources. Some RDEs express interest in working more with municipalities.
12. Provincial Councils		More recent than municipalities. Functions vary, but most concentrate on roads and schools, using central funds. Code is similar to Municipal Code. Elected Council and executive (prefect).	Good equipment and some good technical, ample central funds.	Some have poor relations with municipalities for political reasons, while others work closely with local government.
13. Governors		Named by the President. Maintain civil registers, control police, and carry out political duties. Sponsor some projects with special funds.	Political power, plus special project funds.	Little relationship with municipalities, and some political competition.
14. Central University	Faculty of Administration/ Institute of Administrative Studies (IEA)	Could provide technical assistance to municipalities. Has given some courses and technical support programs.	12 professionals plus other professors. Some funds.	Willing to cooperate.
15. Central American Business Management Institute (INCAE)		Recently opened unit in Ecuador. Could provide top management training assistance. Similar experience in other countries.	2 professionals in Ecuador, access to strong team from outside. Training materials on management.	Interest in cooperating.

The Ministry of Finance's Disbursements Section, which handles FONAPAR, has recently begun to offer courses in budget administration to municipalities.

The picture that emerges in this area is very dispersed. Each agency or organization (with the possible exception of IEA) has a particular motivation and area of interest, mainly related to the enforcement of national laws and regulations. There is not presently available the kind of integrated training in financial administration, particularly in local revenues, establishment of services rates, etc., which the municipalities need for their own purposes. This capacity may have to be developed with the Association of Municipalities, or as part of an expanded involvement of BEDE or FONAPRE.

#### Development Planning

The CONADE regional and urban planners, some of whom were involved in the urban analysis exercise referred to in Section B-2 of this study, are clearly dedicated to improving the capacity of municipalities to plan their development, and seemed understanding of the difficulties faced by local administrators. Advocates of a more integrated rural/urban view of municipal development, they admitted that this idea had not been carried forward once a UNDP assistance project was terminated before its completion. They also cited opposition to the integrated concept by "pure ruralists" who view the urban centers as exploiters of campesinos.

The CONADE planners were proud of some of the earlier products of their collaboration with UNDP and OAS regional planners, including a set of guidelines for basic social services for municipalities, guidelines for conducting project studies (used by FONAPRE), and a number of the studies of local development issues which were prepared in the late 1970s.

This group has probably had more on-ground contact with more municipalities than have others in CONADE or other central agencies operating out of Quito. They maintain that they are the only agency that has the field knowledge and the "purely technical criteria" to assist municipalities in planning. In their view, the Association of Municipalities is not staffed to do the job (and often opposes central authority), and BEDE and FONAPRE are interested parties, since they are lending agencies.

In many respects, CONADE is the right place to turn for planning assistance, for the reasons they put forth. On the other hand, they are wedded to the budget-control, national-priorities realm of government, and are the authors and defenders of the high standards and complex study procedures cited as being inappropriate for many municipal problems and decisions. Should they become interested in a more bottom-up perspective, and in carrying the appropriate technology concept into the realm of local planning, they might be able to play a significant role.

The regional development entities were only superficially reviewed for this study, so little can be said about their present or potential role in transferring planning skills to the municipalities. The impression is that they work on their own, according to CONADE principles. However, as part of the decentralized system, they could be a resource to be tapped in the future.

BEDE presently has a quite clearly defined, limited role to play as a banking institution. Borrowers, whether other national agencies or municipalities, are expected to present their projects already planned and packaged, and in conformance with national plans and local plans. At present, the Bank is reaching the adequate staffing level to carry out the current limited mandate. BEDE is, in terms of its municipal role, a project bank, not a municipal development institution equipped to deal with the full range of concerns. By this is meant:

- (a) projects, like the expansion of the number of houses served by treated water, are the focus, not programs, like the overall health/sanitation needs, costs, and management of that system;
- (b) funding of the projects, not their planning, nor their execution or subsequent management, are the concerns of BEDE now, meaning that little skill or learning is being purposefully passed by BEDE to the municipalities in the areas of project design, oversight and management;
- (c) financial capacity of the municipalities, or of the projects themselves, is of limited concern to BEDE because its loans are secured by central government transfers. To the extent that BEDE is concerned, it is concerned for the projects for which they have provided funding, rather than for the broader financial capacity of the municipalities, even though this may affect their potential as future BEDE clients.

- (d) project preferences, or eligibility for BEDE funding is presently limited to the typical list of urban social infrastructure, thereby offering little to municipalities who have clear priorities for the expansion of the tax base and employment possibilities along with the improved urban services.

This should be read as a description of BEDE, not a criticism of it. The distinctions made above are intended to clarify that a project bank is not a municipal development institution until its mandate is broadened, or its interpretation of its existing mandate is broadened. BEDE's senior staff is open to ideas along these lines, while remaining operationally true to the project bank way of looking at situation.

FONAPRE lends money for studies. Currently a team from Clark University's cooperative agreement on rural-urban linkages is working with FONAPRE to sketch out a pilot effort to work with selected municipalities on planning which would lead to some market town, service-center development. FONAPRE has taken an active role in the joint efforts with BEDE and AID to open dialogues with municipalities, and to look at broader capacity-building issues. However, FONAPRE is an arm of CONADE, and its approaches to planning and project design are heavily influenced by large-scale infrastructure planning, rather than simplified approaches appropriate to municipalities. It is also a funding organization, like BEDE, that is having great difficulty in placing its funds, particularly at the municipal level. Its standards are high, and the studies, and the procedures required to initiate them, tend to be costly and lengthy.

It is therefore unlikely that FONAPRE will be interested in supporting a series of low-cost, simplified planning exercises, given that the procedures are the same, whether the study loan is for \$/1. million or \$/100. million.

Recently the Ecuadorian Housing Bank (BEV) has expressed interest in assisting municipalities with their planning problems. The BEV is now expanding into the areas of low-cost housing, with a new AID project aimed at secondary cities. Clearly their project implementation will be simplified if there is strengthened planning capacity in the municipalities. We can't say at this time what approach to planning (whether comprehensive or

land-use oriented, urban-focussed or rural-urban, high-technology or simplified, expert-dominated, or participatory) the BEV would take.

Again, as in the case of financial management, there are a number of institutions with varying agendas that are, or could be, of support to the municipalities. In order to find common ground among them, and reduce the amount of shopping around that municipalities have to do to find help, it might be necessary to convene an interagency group on this topic for a structured working session. The objective would be to find out if there is a planning approach that can be tested that is (a) less elaborate (in terms of physical planning), yet (b) more comprehensive (economic-urban-rural) and (c) participatory than the approaches that have been applied in the past. The CONADE "lineamientos", or standard terms of reference for urban planning (regarded by FONAPRE as overly complex) might be simplified, and used as the basis for a training program to impart skills to local technicians. Alternatively, a whole new approach might be developed in a search for "appropriate planning technology", such as an investment priorities guide plan, and simple land use mapping. Within this program, municipal officials would pursue a mixture of specific activities, some of them purely local in nature, as well as others related to national development emphases.

### Project Development

This is probably the best-known game in town. It is an area where talent exists in all of the major technical agencies, development funds and banks, and planning offices. As discussed earlier, municipalities need and seek help in this area. They receive it in two ways--by having project plans done for them by agencies or consultants; or by attending formal courses offered by universities or training institutes. The quality and practicality of consultants' reports range from poor to excellent. Studies done for the municipalities by central agencies, such as IEOS, are equally variable, and are often delayed because of conflicting priorities, staff shortages, etc., within the agencies. Formal courses may benefit a very small number of municipal staff from larger cities who have the time to take the courses, and can be spared by the municipality.

What is needed is a method for transferring these skills more widely, through a learning-by-doing process. At minimum, the head of a small municipality's public works

department needs to be able to review intelligently the project plans done by others. Another aid would be a roster of consultants who had performed well for municipalities (and perhaps a list of those to avoid.) This might be done most easily through an information exchange arranged by the Association of Municipalities, in consultation with agencies like FONAPRE and BEDE who know the products of the various firms and individuals who have worked with municipal project development.

In particular, it appears that the economic, financial, and management parts of project plans need strengthening, so that the consequences (operation, maintenance, recurrent costs, organizational implications) of new projects are clearly spelled out for municipalities. At present, we find that project plans are strong on engineering and construction components, but weak or incomplete in the areas cited above.

#### General Management and Administration, Including Service Delivery

There is a clearly established need to improve the general management and administrative skills of municipal administrators, starting with the mayors, council presidents, and councilpersons. Probably a more receptive group is the heads of municipal departments and their staffs, but it is also recognized that the top, elected level will need at some orientation to modern management concepts (as distinct from specific techniques of planning budget review, or billing for water services). We refer here to generic skills in setting objectives, working in teams, exercising leadership and influence, programming activities, skills in supervision, and dealing with the public.

The newly-established branch of INCAE might be of help in this area, and discussions along these lines have started between INCAE and FONAPRE. The IULA Chapter, and the IEA might also be valuable resources for this. The challenge will be to adopt a common philosophy of management to impart, to channel the resources of several organizations, and to adapt training to municipalities in differing circumstances.

In the area of specific techniques of managing water and other services, establishing valorization plans, etc, the main role might be played by the Association, BEDE,

CONADE, or the Ministry of Finances. Our team has suggested that simple manuals for calculating rates, systems of collection, and the like could be introduced. Again, there is need for some degree of standardization, and clear responsibility for this kind of assistance. Computerized systems might be tested in municipalities of different sizes. Organizational aspects need to be looked at, and the political/community relations dimensions specifically dealt with.

As this discussion highlights, institutional relationships with the municipalities are in a constant state of flux. Below is a distillation of the major factors that appear to be influencing this picture.

#### 6. Summary of Factors and Trends

One statement can be made with assurance, that the municipal role in Ecuador's public sector administration and development programs is in the midst of a period of rapid change. And the likelihood is that this will continue into the 1980s. The key factors impinging on this change are:

- (a) The pressure of urbanization, and its resulting shortfalls in basic services, and demands on local governments have created, since the 1970s, a growing awareness of the need to strengthen local government.
- (b) As a consequence of (a) large increases in central government transfers, beginning in 1980, created another new set of conditions that highlighted the need for specific new skills at the municipal (and provincial levels), as well as raising expectations of municipal performance among both central officials and local populations.
- (c) With the growing expectations, and important new tasks to be performed and resources to be managed and accounted for at the local level, it has become clear that management capacity and current expenditure levels are falling behind. Since central transfers are tied to investment, the need to increase local revenues (and capacity to use them well) to cover recurrent costs has become clear.
- (d) The days of Ecuador's reliance on a sequence of booms (banana, coffee, cacao, then oil) to underlie its stability and surface prosperity have passed, bringing

with it the probability that the current level of central spending cannot be maintained. This also places pressure on local authorities to raise income for continued provision of services, and operation of recently built facilities.

- (e) The political awakening that has occurred since 1979 has brought new people into local government, permitted local authorities to challenge central authority in a number of ways, and placed additional demands on national agencies to respond. This has produced discomfort at both levels of government, and such discomfort can be the breeding ground for a reexamination of the patterns of relationships, policies, procedures, and ways of doing business that we have observed.
- (f) Finally, there is a pattern of growing consciousness and initiative-taking at the municipal level that can be built upon, as mayors solve more problems locally, and through their associations and consortia trade their experiences with such innovations as building community consensus for increased taxation, or executing projects with less central intervention, or setting up new ways of managing their personnel and equipment.

### C. PROGNOSIS AND RECOMMENDATIONS

In this final section, a number of topics are taken up. First are some ideas about the concept of municipal development, its internal linkages and a view of the future. Second is assessment of the forces for change and recognition of the unknown impact of the upcoming election. This is followed by (3) a review of the current dialogues, (4) areas of potential change for the Government of Ecuador, and finally, (5) brief reflections on USAID strategy and follow-up.

#### 1. Concepts of Municipal Development

On the following page is a flow diagram (Exhibit 4) of the essential components of municipal action, and points of intervention in that cycle. Based on our diagnosis, it appears that the areas needing most strengthening in the cycle are (a) needs assessment and planning; (b) revenue and other income generation; (c) financial planning and management; (d) staff improvements, and (e) evaluation of both process and impact of the institutional improvements and of the specific programs and projects. In the other

areas of the chart, a certain level of ability already exists, or things will take care of themselves. For example, if economic growth occurs locally, the improved tax base will be there, but if the skills (and political will) to tap that tax base are absent, municipal development will not happen.

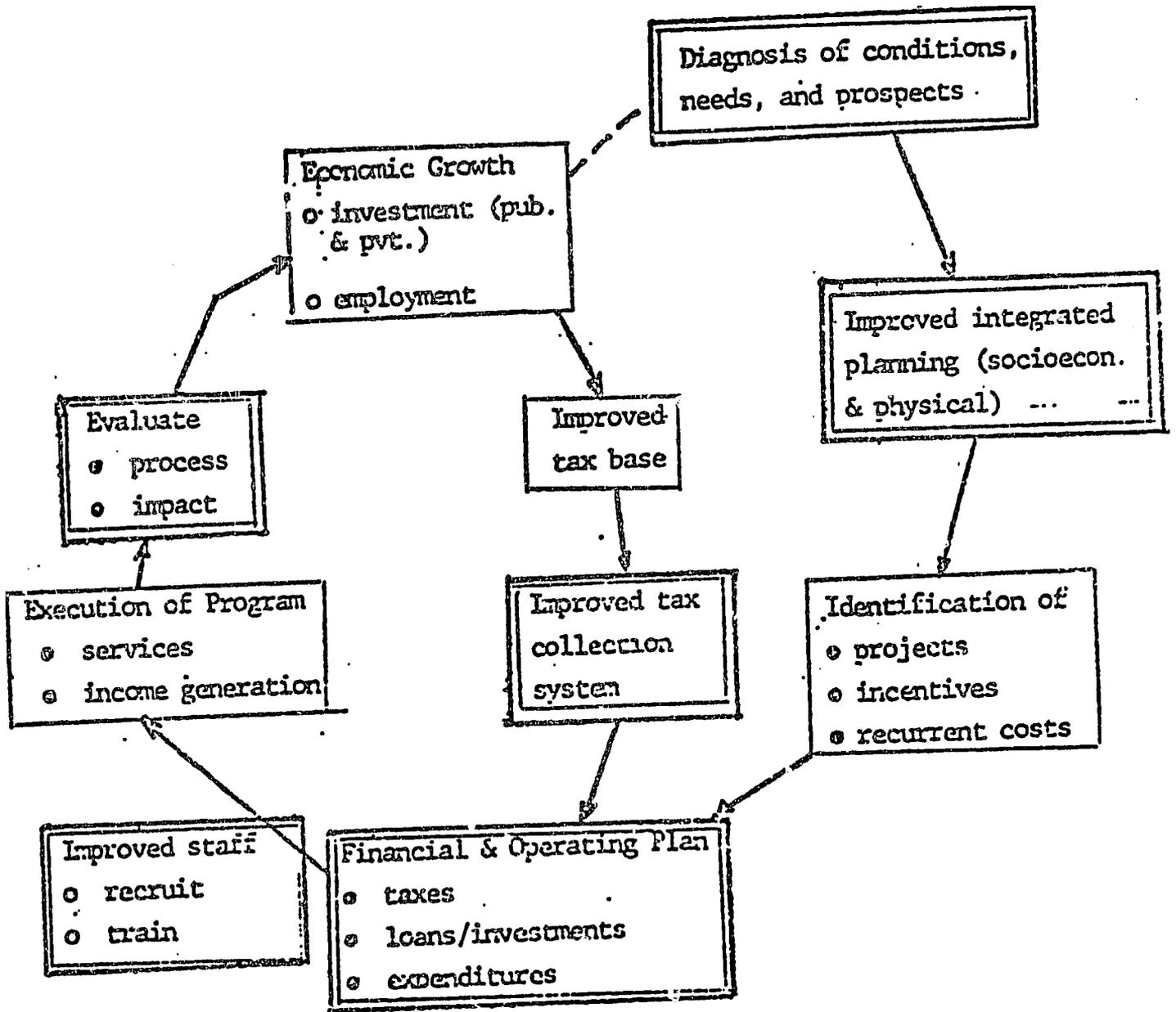
A number of dedicated Ecuadorian technicians and their foreign advisor counterparts have explored the potential of a more broadly focused view of the municipal role in development, and depicted in the next graphic (Exhibit 5). Here, Exhibit 1 presented in Section A is compared with an alternative view in which rural-urban linkages are addressed by municipalities, to the mutual benefit of townspeople and rural dwellers. It is difficult to predict how real or immediate this broader vision is in Ecuador. A lot of work needs to be done to increase the effectiveness of the municipalities within the limited framework and historical pattern (of providing basic urban social infrastructure and services) which they currently understand. However, there are mayors who are looking beyond the town boundaries, are concerned with economic improvements, and would be open to a program of assistance which went beyond the conventional functions and activities.

## 2. Balance of Forces

Our study suggests that there are a number of factors favoring the strengthening of municipalities, as well as a good deal of managed change that will have to occur to take advantage of those factors. Added to the trends summarized in Section B-6 is the interest of international donor agencies in improving municipal administration of development. This interest, shown by the World Bank and the IADB, as well as USAID, is not necessarily based on a philosophical belief in the merits of local level development, as much as on a growing understanding that future lending or program opportunities lie at the secondary city level, and that weak administration at that level is impeding the realization of those opportunities. This is similar to the BEDE and FONAPRE motivation. A recent concrete example of this is the World Bank's decision to require the city of Guayaquil to implement a new cadaster and other administrative improvement as preconditions for a major slum housing/community improvement project there.

A major unpredictable factor for the future of local development is the upcoming election, and the position of

# THE CYCLE OF MUNICIPAL DEVELOPMENT



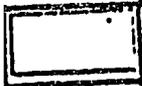
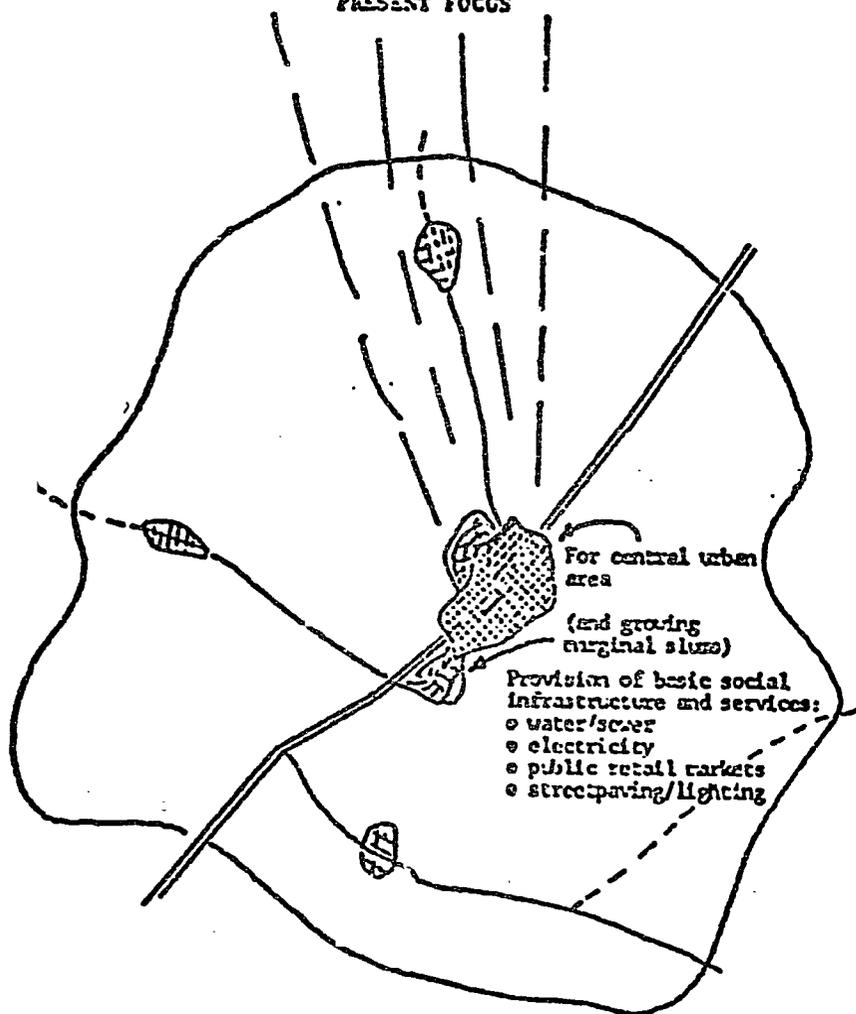
 = Key points for training or technical assistance intervention

Exhibit 5  
 ROLE OF MUNICIPALITIES IN DEVELOPMENT

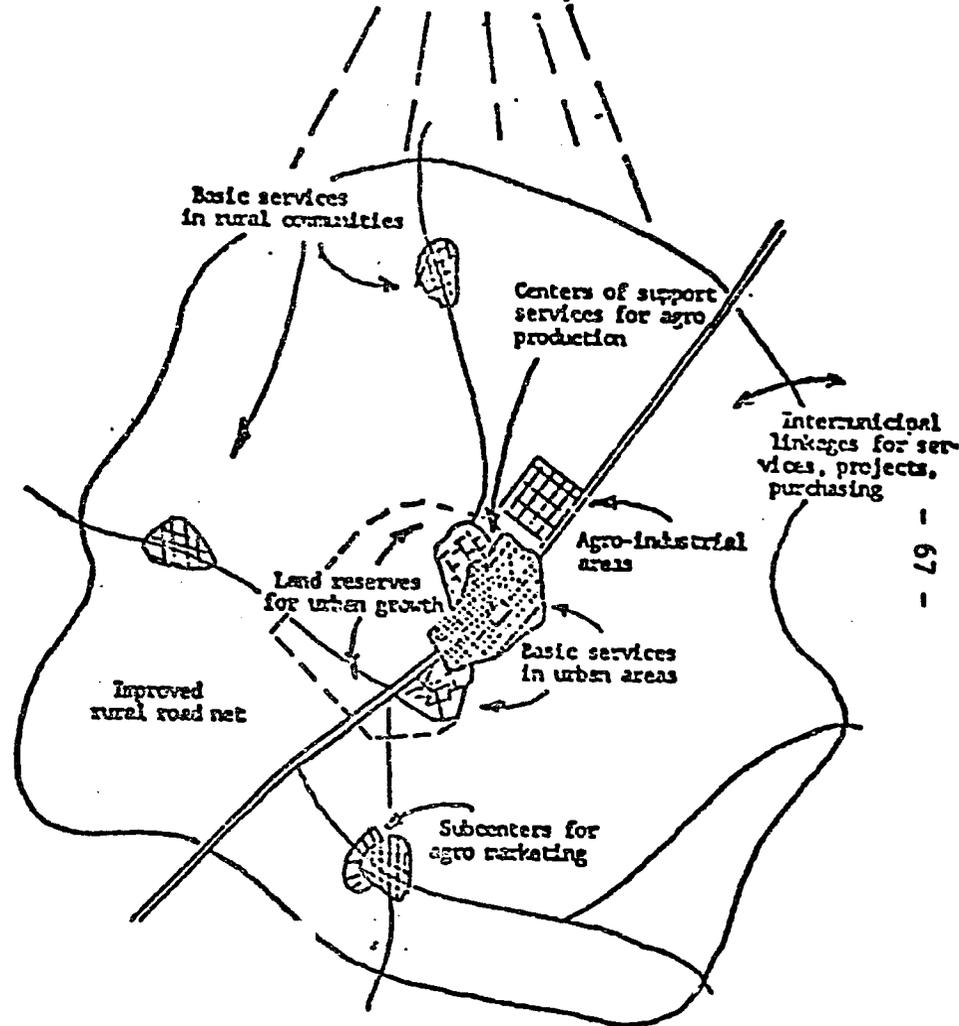
**ECUADORIAN MUNICIPALITIES:**

**PRESENT FOCUS**



**ECUADORIAN MUNICIPALITIES:**

**POTENTIAL FOCUS**



the incoming government on such issues as: (a) emphasis on urban or rural development; (b) their willingness to further or impede decentralization of functions, authority, and fiscal responsibility; (c) their willingness to invest in human capital as well as physical assets, and (d) their responsiveness to innovation and initiative at the local level. It is interesting that a number of mayors have recently resigned to run for seats in the national legislature, which could bode well for municipal reform legislation if they win.

Equally important will be the outcome of local elections. If the populist trend continues, it could mean that expectations of expanded municipal action are responded to. The architectural approach to local investment may be modified further in the direction of job-creating investments and extension of municipal action to the rural areas. If more conservative forces prevail, there could be a move back to the more narrow view of municipal activity.

### 3. Current State of Dialogue

At various points in this paper we have mentioned that there is active interest in moving the municipal agenda forward. The materials prepared for the last National Development Plan are carefully stored for future use. Numerous agencies are reaching out to do their own assessments of municipal needs, and in some instances moving to set up various kinds of training activities.

What is lacking is a sense of shared purpose or direction among the agencies. Given the limited number of capable and experienced people at the national level in the realm of local administration, there is danger of duplication and wasted effort. Among agencies at the central level, with few exceptions, there appears to be more competition and mutual distrust than cooperative exchange. Given a policy vacuum at the top levels of the government, each agency is responding to the municipal situation in its own way.

Between local and national levels, dialogue tends to be focussed on specific, municipality-by-municipality, or project-by-project problems, and is fraught with the many kinds of static described earlier. As the election season heats up, this is likely to become worse before it becomes better.

There are at least two ways to respond to this situation -- people concerned with this issue can lie low until the political season is over, or they can prepare to educate the public, the candidates, and begin building some shared areas of potential action with the interested agencies.

4. Range of Options for GOE Consideration

Assuming receptivity among incoming political leaders, there are a number of policy changes that would be important in order to increase the ability of municipal governments to contribute to national, as well as local, development. Briefly, these include:

- (a) Continue efforts already begun by the Association of Municipalities to modernize and simplify the Municipal Code, making it less prescriptive, and removing the contradictions between the goal of "autonomy" and the many provisions which tend to make the municipalities an extension of the central state.
- (b) At the local level, there is an apparent need to modify, or at least clarify, the role of the provincial councils, and of the national agency offices located at the provincial level. A former mayor of Ambato has suggested that the direct funding and implementation role of provincial councils be reduced or eliminated in favor of a planning, coordination and technical assistance function to support municipal activities.
- (c) The studies and plans of the urban hierarchy, and of its relationship to surrounding rural areas, that were done for the last National Plan, could be reviewed, in order to make some decisions about what the role of different categories of municipalities should be in the future. This in turn could lead to placing some priorities on the allocation of technical assistance, on the distribution of central investment funds, and so forth.
- (d) Many laws and regulations that impede municipal initiative and implementation need to be reviewed to see if the conditions that produced them still apply, to identify duplicative reviews and procedures, and to trim them back to the essential few required to assure accountability. Then training and technical assistance programs should be based on those changes, to assure that the knowledge and skills needed to implement the laws is transmitted to the local level.

- (e) The idea of an Institute of Municipal Development was raised in the mid-1970s, and was discarded at that time. It may be time to examine this idea again. While the idea of creating yet another bureaucracy in Quito may be unpalatable, it is important to establish a focal point for municipal development activities. This might mean expanding BEDE's mandate and role, consolidating under the Bank some of the talent now scattered through other agencies, (including recruitment of some outstanding municipal administrators) and providing a component of grant funds to finance the training and technical assistance agenda.

In addition to these ideas for GOE policy improvement, the team that prepared this study developed extensive lists of specific actions, some of them geared to specific audiences, others to groups of agencies at both the central and local levels. Not all of these ideas are original with the study team. Many of them were drawn from our discussions with knowledgeable Ecuadorians at all levels, from papers prepared by CONADE and others, and from our experiences in other Latin American countries. It isn't necessary to include those ideas for the purposes of this paper, but there were some common themes underlying the strategy for change that deserve mention:

- (a) A comprehensive data base on municipalities is an indispensable starting point for decisions, plans, and specific programs. Such a data base should be accessible to all interested parties, and most importantly, to the municipalities themselves.
- (b) Discussions about policies, procedures, new approaches to planning, or other topics of general interest should include, by conscious decision, representatives of appropriate groups within the ranks of municipal administrators. They have many ideas to offer, and can bring valuable reality checks to such sessions.
- (c) Any additional studies that are done should have a definite purpose, use, and audience, and include a plan for follow-through, whether in the form of a seminar to draw up action plans, or to design a pilot project.
- (e) All new policies, programs, or activities should have a plan for monitoring and evaluation built into them. We have a preference for en-route evaluation sponsored by

the agency responsible for the program, thus allowing for self-evaluation and correction.

5. USAID Strategy

The USAID program direction, as defined in the May, 1983 Country Development Strategy Statement (CDSS), contains many elements that will need the underpinning of more effective local administration. This includes efforts to improve agricultural marketing, production, and agro-industry or small enterprise outside the primate cities; low-income housing and related development for secondary cities; improvement of health conditions through provision of potable water; and on a more global level, the interest in increasing the self-sufficiency, effectiveness, and decentralization of public sector institutions.

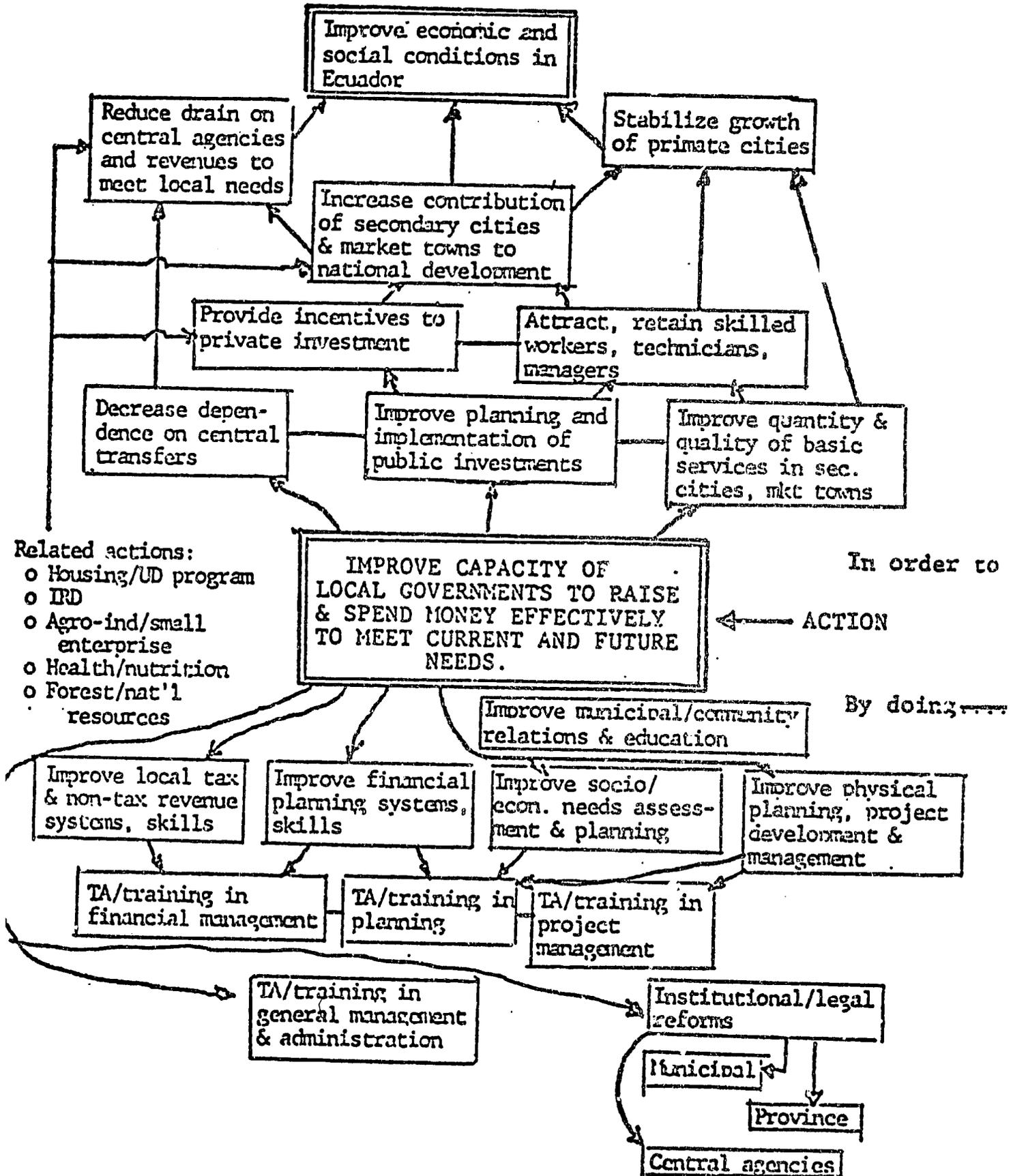
On the following page is Exhibit 6, an illustrative chart of ends and means, which shows the role that a program of strengthening local government could play in pursuing the USAID strategy. Reading from the center toward the top provides possible answers to the question "why do it?", with the response "in order to...". Reading from the center toward the bottom provides suggestions to the question "how to do it?", responding "by doing...".

One way to use this tool is to gather a group of Ecuadorian officials (including, as we've urged, some local ones), put the central proposition in the middle of the chart on the wall, and ask for their ideas about why, and how, to do it. Encourage brainstorming, getting all ideas out without criticism, however wild or new the ideas, and then begin sorting out the best and most feasible propositions, both long- and short-term.

USAID/Ecuador has already begun a number of steps, drawing on the early preparatory work for the SIP, to focus the various explorations of the local government question that are going on in the country. It has sponsored the BEDE/FONAPRE regional meetings with the municipalities, disseminated analyses of local problems among agencies, encouraged pilot projects in revenue generation and rural-urban planning, and generally encouraged an action research approach to solutions to local problems.

The approach used in this SIP process has been one of mutual exploration with the GOE of a national concern (and opportunity). The final appearance of this paper is probably not as important as the questioning, debate,

### RATIONALE FOR MUNICIPAL DEVELOPMENT



definition and clarification of issues that has occurred during its preparation. We support the proposition that this will be an ongoing process, with additional topics explored as needs arise.

Some of the topics which might be pursued in the future, as they may bear on local government problems and potentials, include:

- (a) To reach a deeper understanding of local, non-governmental perceptions of municipal and provincial governments by people in the rural and urban areas of selected municipalities, in order to better gauge their expectations and suggestions for improvement;
- (b) To examine further the organization, performance, and potential of the provincial and regional entities and their interactions with the municipalities, in order to understand what they see their present and future role to be, and what needs to happen to improve performance; and
- (c) To establish a typology of municipalities (and other subnational entities), in order to identify different needs and potentials for development, and the related approaches required.