
SUMMARY OF FINANCIAL MARKETS IN ECUADOR: SECONDARY SOURCE SURVEY

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ECUADOR

SUMMARY OF FINANCIAL MARKETS SURVEY

A. ENVIRONMENT

1. Stable political climate

The current administration of President Leon Febres-Cordero favors a strong private sector and has recently (August '85) gained the majority in the legislature. The president may lose control of Congress, however, if he is unable to postpone the coming provincial elections.

There is growing concern over terrorist activities in the country. In 1985, the terrorist group "Alfaro Vive" kidnapped Nahem Isaisas, owner of the second largest bank. Both kidnapers and Isaisas died in an attempted government-led rescue mission. The same terrorist group also planted a bomb in the Ecuadorian Embassy in Bogota and occupied the Mexican Embassy in Quito for a short period.

2. Economic climate

Ecuador, as an oil producing nation, is highly sensitive to the changes in the petroleum market. The continuing reduction in petroleum product prices is causing significant reductions in GOE's revenues. The uncertainty surrounding further price fluctuations is complicating development planning by GOE. Most of its other major exports (shrimp & other seafood, bananas, coffee and cocoa) were adversely affected by the natural catastrophe, the "el Nino" ocean current, in 1982 and have only recently recovered.

Under the new administration several improvements have been made. The current account for 1985 may have a small surplus, inflation has dropped to just below 15% and the GDP is expected to show a moderate rise of 3.5%. The government has encouraged diversification of exports to reduce dependency on oil and has managed to reschedule its foreign debts. The United States is seriously considering extending a US\$500 million loan to Ecuador.

3. Stable social climate

Ecuadoreans are mostly mestizo, a mixture of Spanish and Indian stock. The national language is Spanish and the majority of the country is Catholic.

4. Multilateral Donors

- IMF
- IFC
- IDA
- World Bank
- Inter-American Development Bank (IDB)
- Corporacion ANDINA DE FOMENTO

5. Major bilateral donors

- United States
- United Kingdom
- Italy
- Federal Republic of Germany

6. IMF Stand-by Agreement - SDR 105.5 million.

B. ECONOMY

Ecuador has a mixed economic system. It is a member of the Andean Common Market although it has threatened to quit if policies concerning foreign investment are not liberalized.

1. Public sector

During the period 1973-1982 the public sector value increased from 23 to 34% of GDP. There was a major expansion of regional administrative institutions although most decisions were still made in Quito. Public investment was funded mostly through credit from the international capital markets. Savings from the public sector financed only 24% of capital expenditures in 1982. As of 1983 the public sector ran at a deficit equalling 1.4% of GDP.

Major non-financial parastatals

a) The State Petroleum Corporation (CEPE)

The institution manages the production, international marketing, and domestic distribution of petroleum and petroleum products. The corporation handles 63% of the country's exports and accounts for 40% of the country's public revenues.

b) The Ecuadorian Electricity Institute (INECEL)

The parastatal is a holding company as well as a prime generator and transmitter within the national electricity system.

c) National Entity of Vital Products (ENPROVIT)

The agency subsidizes consumption of basic food products.

d) National Entity for Storage and Sale of Agricultural Products (ENAC)

The agency intervenes in the agricultural commodities market to smooth seasonal fluctuations.

e) The Ecuadorian Social Security Institute (IESS)

The institute receives all of its funds through mandatory contributions from the labor force. The Central Government has not paid its share of employer's social security contributions for the last twenty six years, refinancing its debt on concessionary terms. As of 1982, 39% of the Institute's investments were in government bonds.

IESS may be facing major financial problems in the future due to the disparity between contributions and scheduled obligations. The World Bank mission estimates that, in the long run, contributions will cover only 25% of benefits.

2. The private sector

a) Agriculture

The bulk of the nation's farm resources, including technical knowledge and management capabilities, is currently in the commercially oriented sector of the rural economy. Commodities such as cocoa, bananas and coffee generate substantial amounts of foreign currency.

b) Industry

The industrial sector, both the formal and informal, grew at an average of 9.2% per year during the period of 1972-1982. The formal industrial sector developed as a consequence of tax initiatives, foreign credit and the government's import substitution policy.

In contrast, the small scale enterprises and the cottage industries increased due to growing demand, receiving little government support. Of approximately ten thousand new jobs created during the 1970s the formal sector accounted for one third of the jobs while the informal sector was responsible for the remaining two-thirds.

c) Non-banking financial institutions

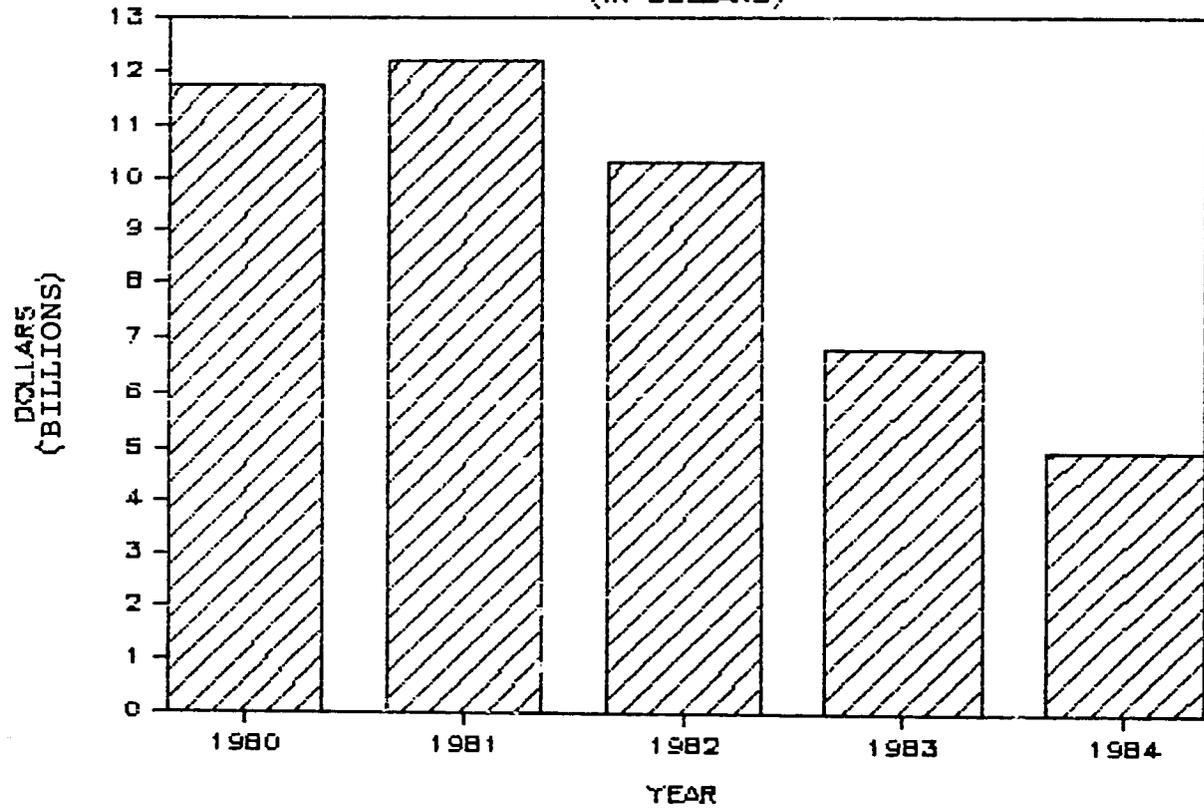
Although the institutions increased in numbers at an impressive rate, they have not become a major force in domestic resource mobilization (see section E).

d) Labor force distribution

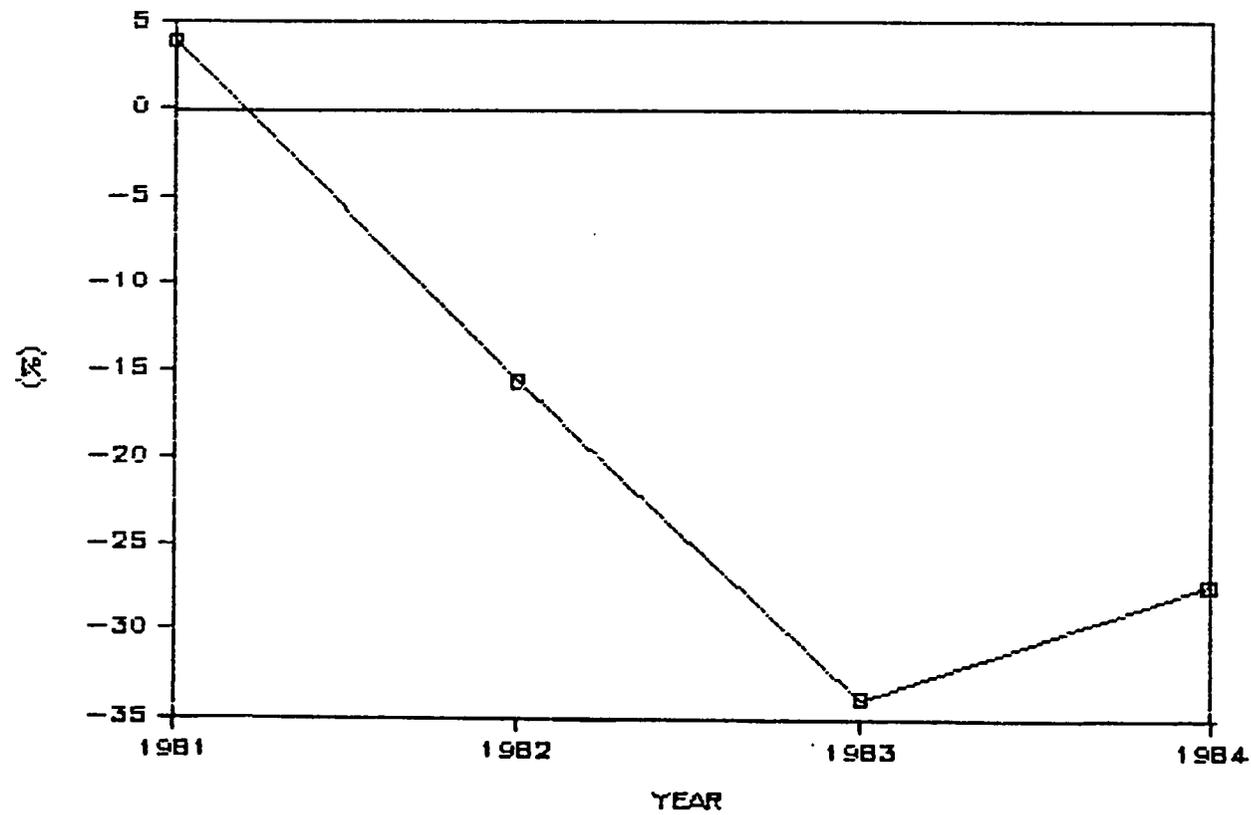
◦	total population	9.11 million	
◦	labor force	3.10 million	
			% of labor
◦	agriculture, forestry and fishing		46.1
◦	mining		0.3
◦	manufacturing industries		10.7
◦	transportation utilities and communications		3.1
◦	construction		5.0
◦	commerce		11.2
◦	finance and insurance		1.2
◦	government and personal services		15.8
◦	non-specified services		6.6

GROSS DOMESTIC PRODUCT

(IN DOLLARS)

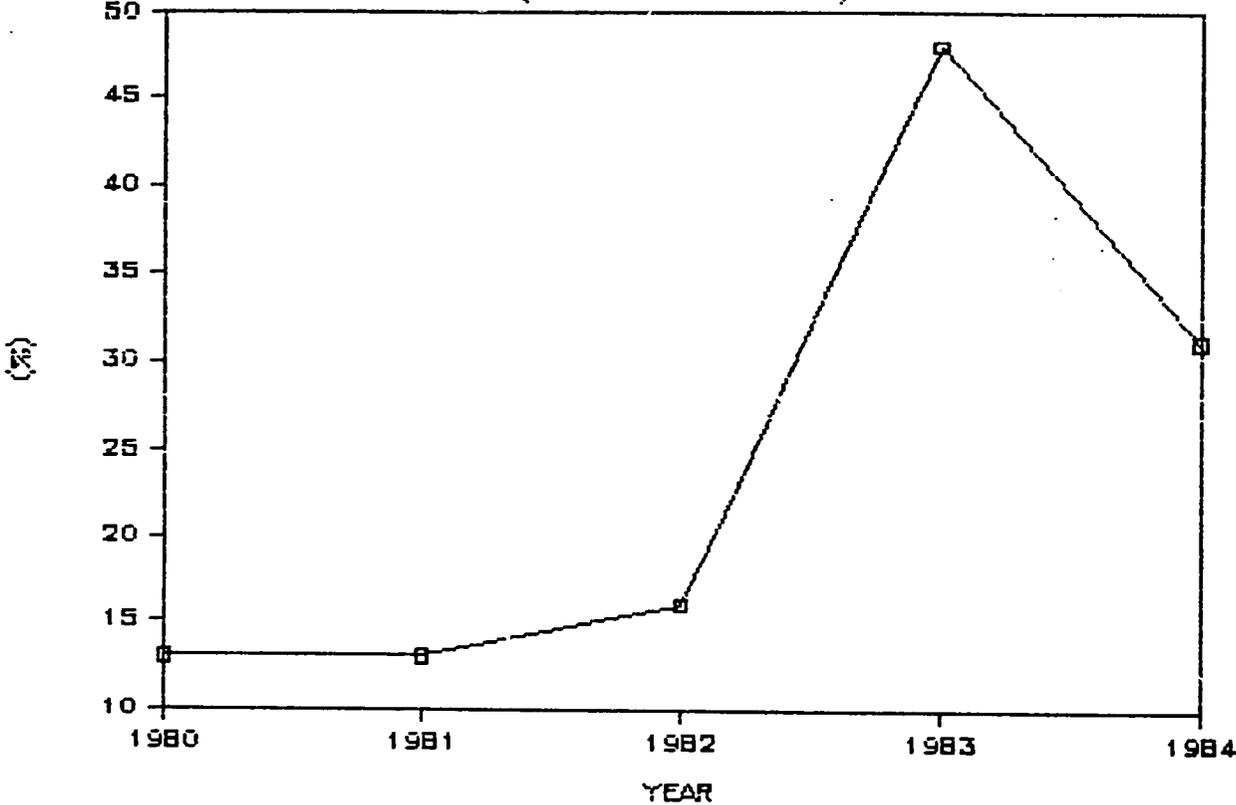


GROWTH RATE OF GROSS DOMESTIC PRODUCT



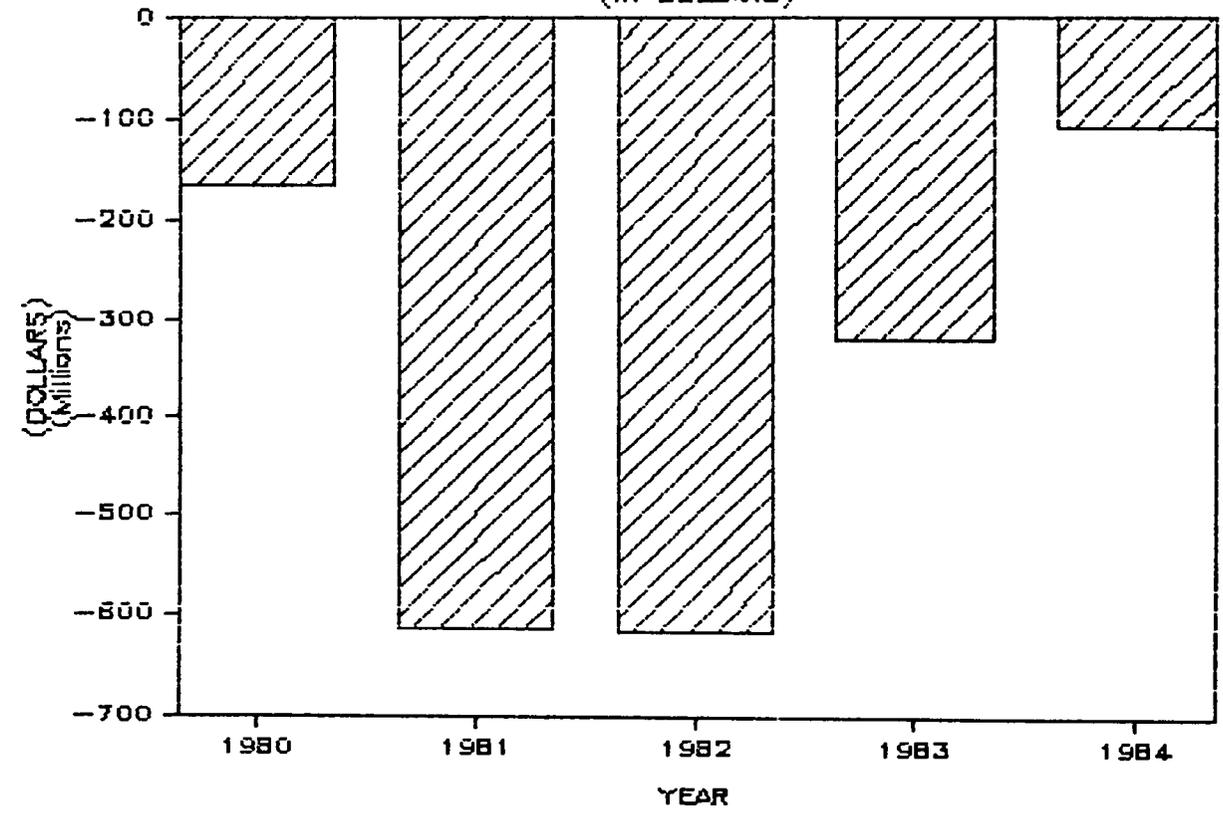
ECUADOR'S INFLATION RATE

(BASED ON CPI INDEX)

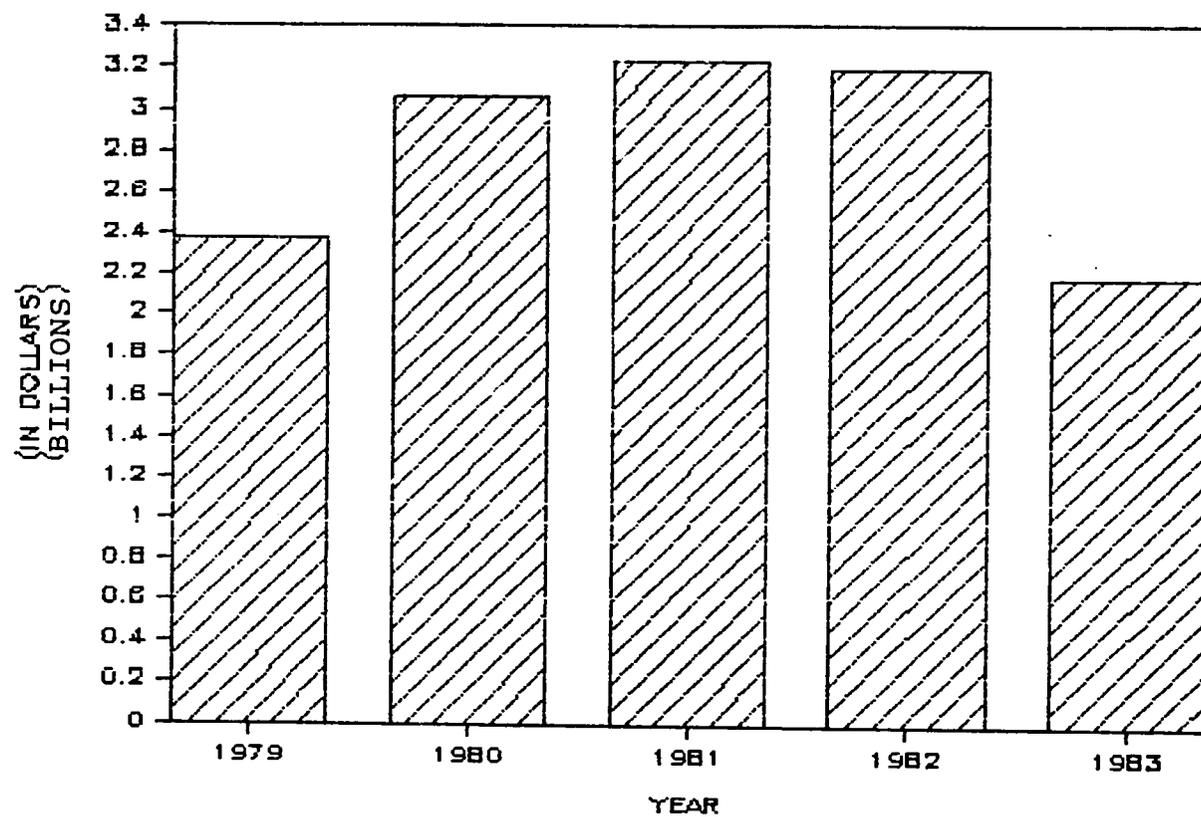


OVERALL DEFICIT/SURPLUS

(IN DOLLARS)

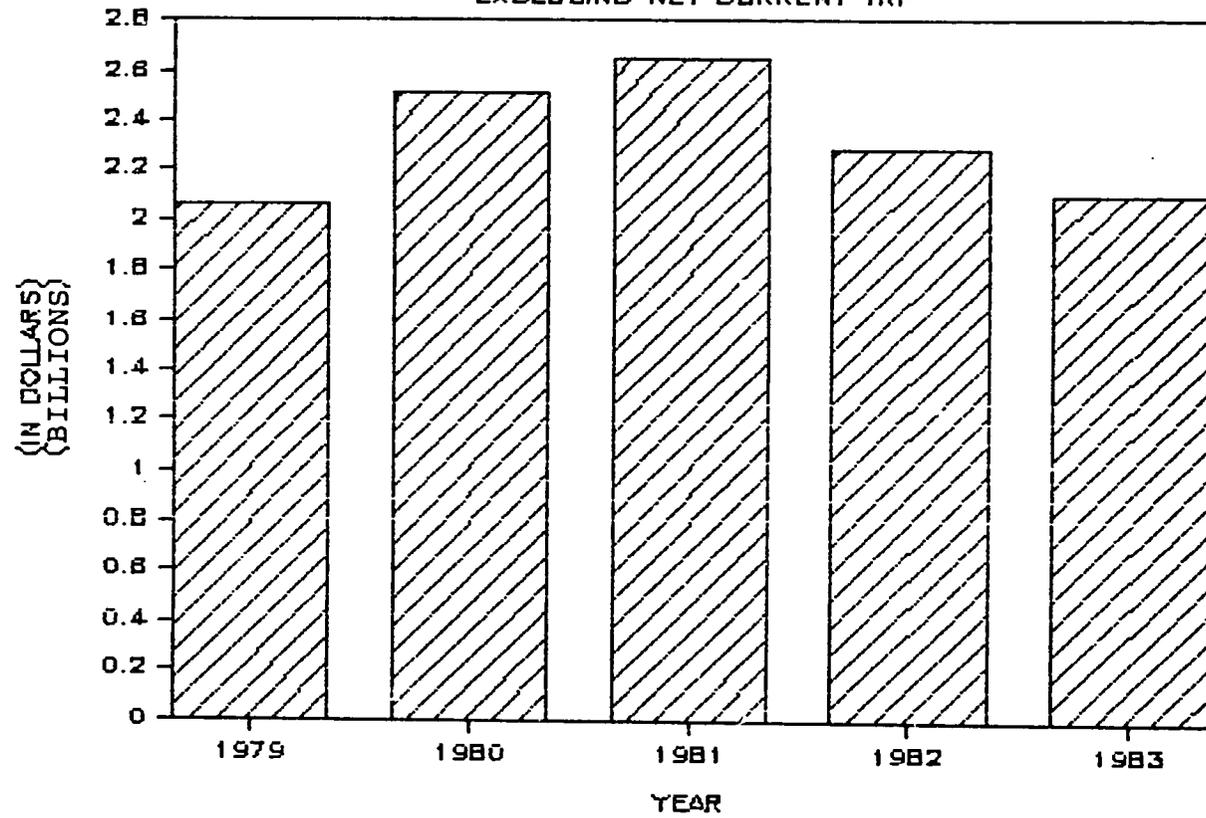


GROSS DOMESTIC INVESTMENT



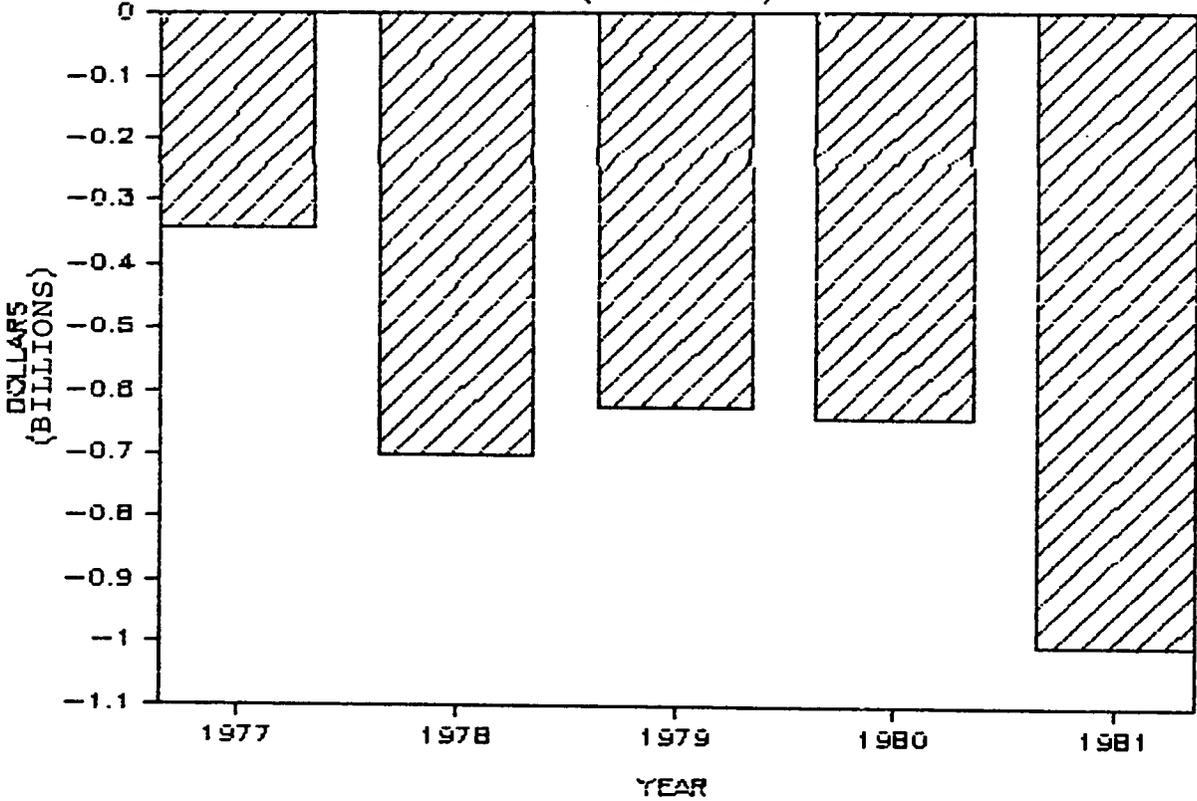
GROSS NATIONAL SAVINGS —

EXCLUDING NET CURRENT TRF



CURRENT ACCOUNT BALANCE

(IN DOLLARS)



C. GOVERNMENT ATTITUDES

The current administration of Leon Febres-Cordero, as previously mentioned, is promoting the private sector and reducing the government role. Thus far, the administration has been willing to discuss and resolve politically sensitive issues. For instance, Ecuador has been one of three debtor countries which has rescheduled loans with both western governments and private commercial banks. The government has increased foreign investment by abandoning official currency exchange rates and fixed interest rate, providing other guarantees on remittances of profit.

1. Private sector participation

The Monetary Board (see Section E) which is responsible for setting the national monetary policy includes a representative from "la Costa" Chamber of Commerce and Industry, another member representing the Chambers of "la Sierra" and "el Oriente", and a representative from the commercial banks.

2. Profits

As of 1985, companies were required to distribute 15% of their net profits to their employees in addition to regular salaries.

3. Private sector growth incentives

During the 1970s the government policies encouraged domestic investment through negotiable tax credit certificates, preferential interest rates and funds. These factors along with high export taxes (up to 27% of profits) and an official exchange rate which undervalued the sucre led to a substantial reduction in exports with the exception of the government-controlled petroleum.

The government, in view of the softening of the oil market and the change in administration, has now moved away from the protectionist attitudes of the 1970s. While the government still supplies funds to the private sector, it has abandoned most of its old incentives and has, instead, increased competition in the market. Foreign investment rose by 14% in the first six months of 1985.

4. "Sucretization" Program

The program is designed to help alleviate the foreign debt problem for the private sector. The Central Bank will assume the foreign debt of private enterprises in exchange for an equivalent obligation to the Central Bank assumed by the companies. As of 1983, US\$1.2 billion had come under the arrangement.

5. As of 1984, the government was in the practice of earmarking portions of the oil tax revenues to different parastatals.

Petroleum Tax Recipients

	%
Government budget	43.9
INECEL	8.0
CEPE	13.1
BEDE	10.3
Others	24.7

D. REGULATORY CLIMATE

1. Foreign Exchange control

Ecuador has abandoned its official exchange rates used for merchandise trade (Su67.5/\$US) and has adopted the Central Bank "intervention" rate (Su96.7/\$US).

2. Price controls

GOE had set official prices for farm commodities such as wheat, rice, sugar, meat and milk. It also regulated to a lesser extent corn, soybeans and cotton. GOE subsidized energy costs (electricity and petroleum products). However, a recent article in The Economist (1/24/86) stated that GOE has abandoned most subsidies and price controls, but it did not provide specifics.

3. Labor laws

The cost of labor in Ecuador for the formal sectors is relatively high. The minimum wage is Su8,500 per month for most sectors except for agriculture and domestic work. In addition, employers must pay a variety of other benefits which total approximately 70% of the monthly wages. Labor unions are well organized in Ecuador.

4. Restrictions on institutional investors

The major institutional investor, IESS, is required by law to hold a large percent of its assets as low-interest bearing government securities. Insurance companies can hold only government securities.

5. Foreign ownership limitations

GOE encourages foreign investment. In 1985, GOE reached agreements with Texaco, Conoco, Exxon, BP, Occidental and Belco regarding the exploration and production of petroleum products.

Foreigners cannot invest in the following activities:

- o fisheries
- o mass media
- o consulting services
- o electricity
- o telecommunications
- o air and water transportation
- o strategic and national defense

Foreigners must have prior authorization from the Ministry of Industry and Commerce to engage in finance activities. They may remit up to 40% of their profits.

6. Regulation of industry and commerce

Businesses must register with the Mercantile Register. They must keep four books: a journal, a ledger, an inventory account and a cash flow account. Independent auditing is also required.

7. Stock exchange supervision

The Superintendent of Companies supervises the stock exchanges.

E. FINANCIAL SYSTEM

1. The monetary system and financial institutions

a) La Junta Monetaria (the Monetary Board)

The Monetary Board appoints the General Manager of the Central Bank and is in charge of making the monetary policy of the country. Its duties are:

- setting the level of interest rates
- setting the Central Bank credit amount
- setting the minimum reserve requirements for banks
- deciding on the import deposits amounts
- setting the exchange rate
- regulating capital flows into and out of Ecuador
- deciding on other factors affecting the balance sheets of financial intermediaries

b) El Banco Central (the Central Bank)

The Central Bank is responsible for executing the policies of the Monetary Board. It provides substantial credit to both financial institutions and directly to the public. Specific activities are:

- providing discount and rediscount facilities
- awarding rediscount credit to priority areas through "los Fondos Financieros" (financial funds)
- purchasing all Banker Acceptances
- providing pre-export credit to Ecuadorian firms

c) The Bank Superintendency

The office regulates banks and other financial companies including insurance companies. It publishes banking statistics.

d) El Banco Ecuatoriano de Desarrollo (BEDE)

The Ecuadorian Development Bank is a parastatal established to manage the finances of public sector development projects. The bank also negotiates with multilateral donors, like the IDB, in arranging

development projects and provides the required matching funds. Its domestic sources of funds include petroleum revenues, and funds supplied by the Central Bank directly and through the finance funds, such as FONADE.

e) Banco Nacional de Fomento (BNF)

The National Development Bank concentrates on the country's agricultural development. However, the bank has been plagued with problems. Commercial banks are the main institutions providing credit to farmers. Furthermore, as of 1983 the main source of credit (60%) came from money lenders, large commercial farmers and non-bank financial institutions. These loans were generally short-term and required no collateral.

d) Banco Ecuateriano de Vivienda (BEV)

The Ecuadorian Housing Bank provides mortgages and issues mortgage bonds.

e) Banco de Cooperativas del Ecuador (BCE)

The Ecuadorean Bank for Cooperatives.

f) Parapublic finance company - Corporacion Financiera National (CFN)

The National Finance Company is the largest lender to the private sector supplying 48% of the available credit. It founded Ecuador's Stock Exchanges.

g) Private sector finance companies

The private finance companies provide short term funds to industries, agricultural enterprises and commercial businesses. There are twelve private companies. Six major "financieras" are:

◦ Corporacion Financiera Ecuatoriana (COFIEC)

The Ecuadorian Finance Company, the largest financiera, specializes in project financing.

◦ Financiera Iberoamericana (FINIBER)

◦ Ecuatoriana Financiera, S.A.

◦ Financiera Nacional, S.A.

◦ Financiera de Guayaquil

◦ Financiera del Astro

h) Commercial banks

There are thirty commercial banks in Ecuador including four foreign subsidiaries (see Appendix). Most of the banks have several branches.

i) Savings & Loans Associations (Asociaciones Mutualistas)

There are eight S&L associations. They supply funds to the housing and real estate sector.

j) Insurance companies

There are 27 insurance companies, but because of government requirements, the insurance plays a minor role in the financial system. Less than 0.3% of the population is covered by these companies.

k) Foreign exchange houses

l) Warehousing firms

There is one warehousing firm. It sets up short term financing with merchandise guarantees.

m) Leasing companies

These companies have been fairly inactive. There are currently no tax incentives favoring leasing.

2. Current interest rate limits

- maximum interest rate payable 23% per year
- passbook interest rate 20% per year
- Certificate of Deposits, savings policies and short-term notes 22% per year
- for mortgage bonds, collateralized debentures, general & specific guaranteed bonds, mortgage loans and other long term instruments 23% per year
- bonds for development projects 18% per year

Short term instruments for one million sucres or more are exempt from the limit.

3. Recent financial system reforms

During the period of 1973-1982 the financial system experienced substantial disintermediation as a consequence of the restrictive interest ceilings, the FX policy and the import substitution policy.

The Febres administration is attempting to reform the financial system in order to improve domestic savings mobilization. In addition to the new interest rates, the administration has passed other legislation:

- parastatals can hold accounts with private banks.
- the time limit for foreign debt has been extended seven years.
- the Monetary Board need not explain increases in the money supply.
- the S&L associations can adjust interest rates in line with inflation on long term credit.
- the Monetary Board may grant credits to financial institutions in distress as it sees fit.
- the Bank Superintendency has extended supervisory powers.
- company boards of directors and shareholders have increased legal say on company actions.
- reserve shortfalls are now penalized by a 4% surcharge on the interest rates.
- a maximum limit has been placed on reserves for bad debt at 10% of the accounts receivables.
- banks and finance companies can merge while retaining both types of operations.
- S&L associations and finance companies can offer "pólizas de acumulación". The instrument is a special cash deposit with a floating interest rate. Minimum deposit is one million sucres.

4. Financial Markets

The financial markets of Ecuador are not well developed. Short term money market instruments are the main securities traded. There are 24 different common stocks listed, but they are traded only occasionally. Most companies are closely held, and as of 1985, there were no incentives for them to go public. During the 1983-1984 period the value of new securities decreased in real terms by 20%. Securities traded in the secondary market lost 30% of their value.

a) There are two stock exchanges in Ecuador:

- La Bolsa de Valores en Quito
- La Bolsa de Valores en Guayaquil

b) Banks are not active in the securities market. Some banks, though, do own brokerage subsidiaries which are members of the exchanges.

c) Securities placement and underwriting

There are no set rules for the public placement of securities by non-financial firms. Placements by finance firms are regulated. The fees for underwriting secured bonds and stocks are 2%. For non-secured stocks the fee is 4%. In 1984 three fourths of the private and public placements came from the private sector, with the non-finance companies offering the most securities.

d) Institutional investors

Institutional investors play a limited role in the market. IESS concentrates its assets in mortgage bonds and government bonds.

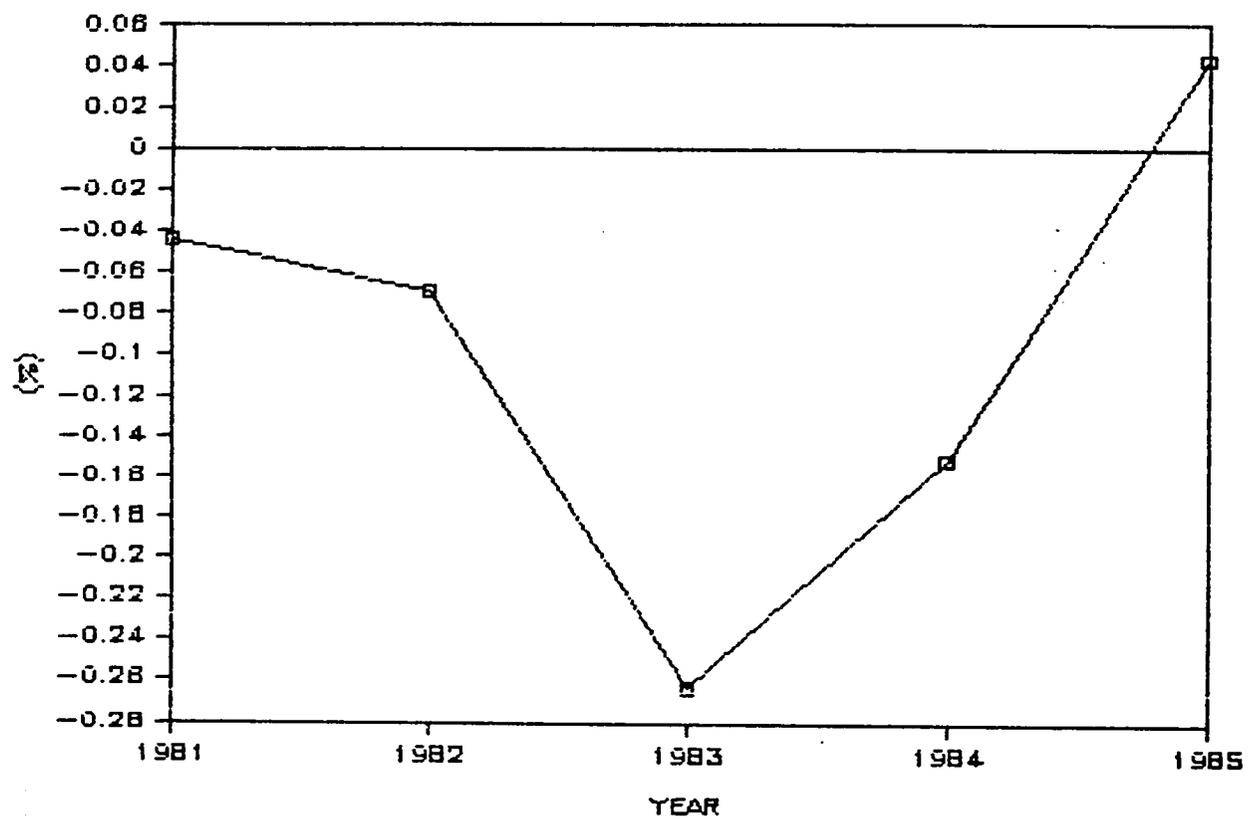
e) Secondary market volume for 1984 percentage of instrument total volume

mortgage bonds	37.8
treasury bills	32.0
banker acceptances	6.3
collateralized bonds	6.2
finance companies' bonds	5.2
finance companies' commercial paper	4.9
government bonds	4.1
tax credit certificates	3.3
common stocks	0.3
others	0.1

f) secondary parallel market

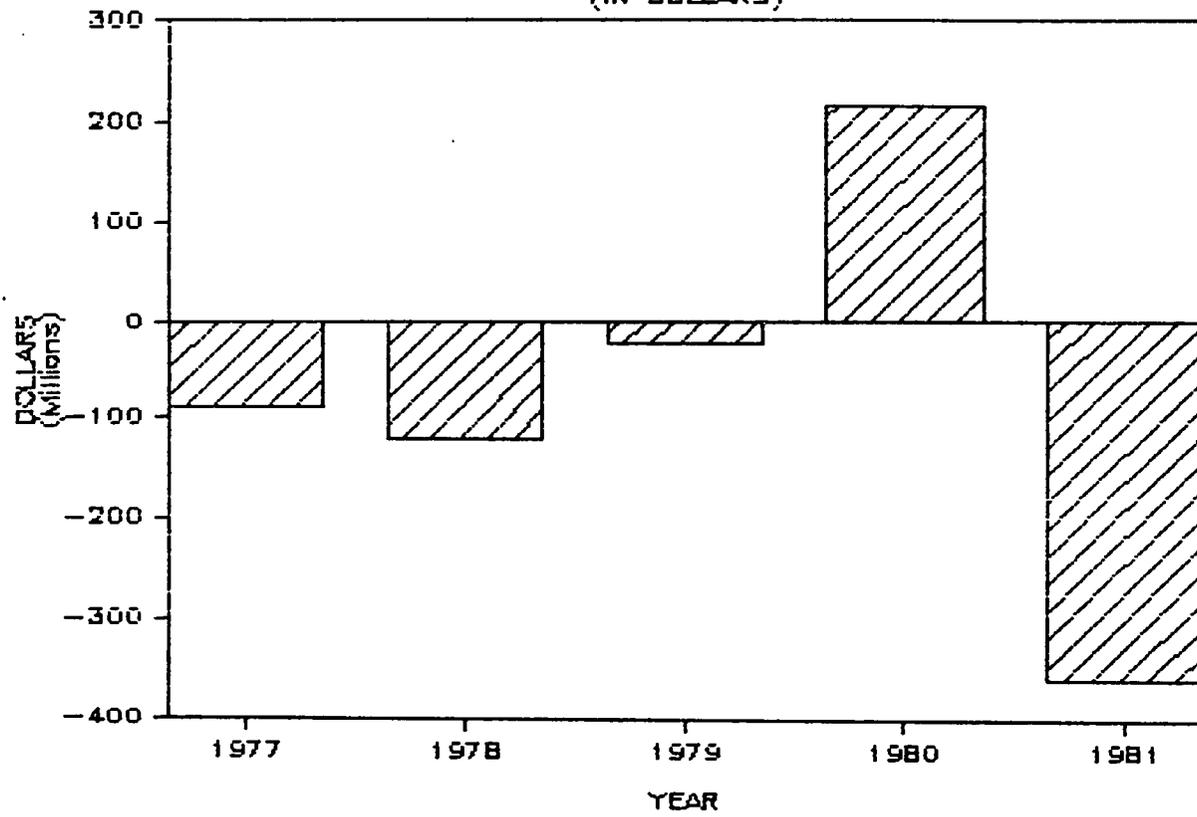
Although there are no statistics on the activities of the market it is believed to be sizeable.

ECUADOR'S REAL INTEREST RATE

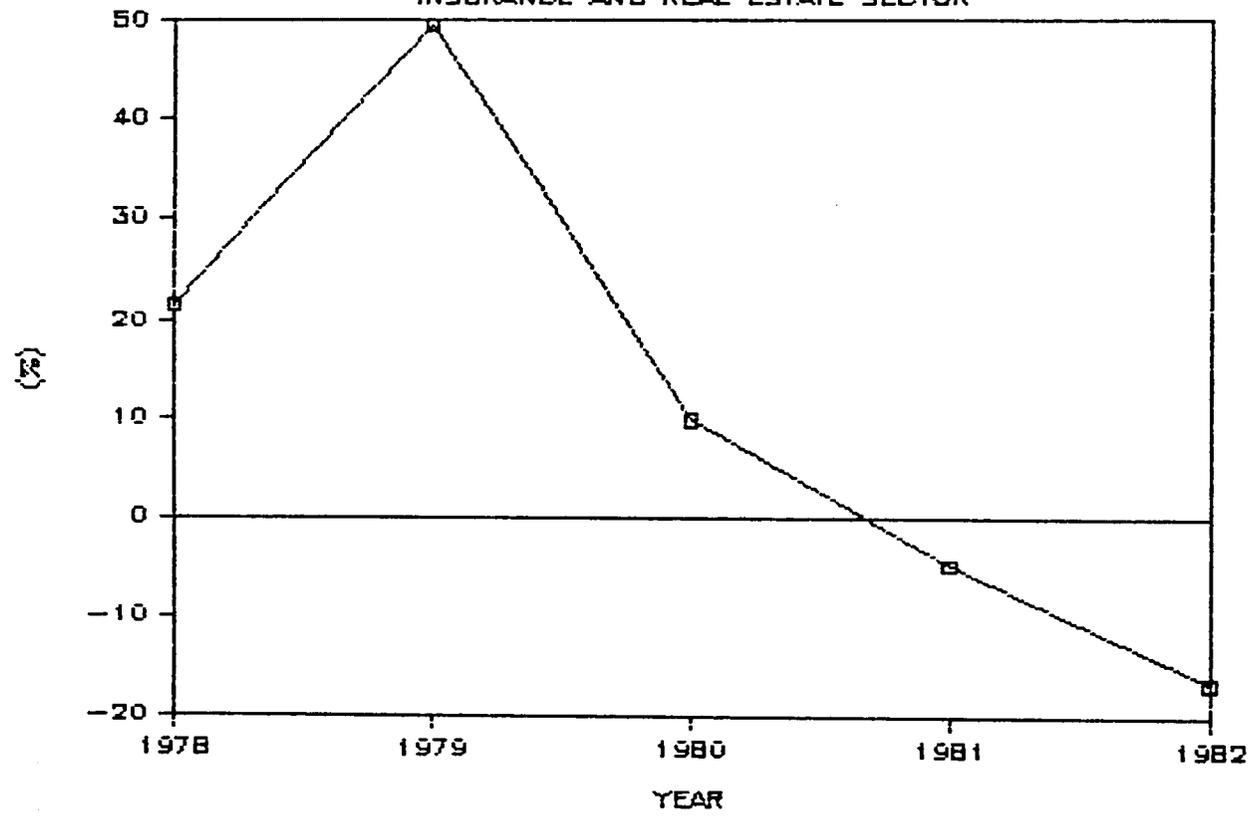


SHORT TERM CAPITAL - EXCLUDING RESERVES

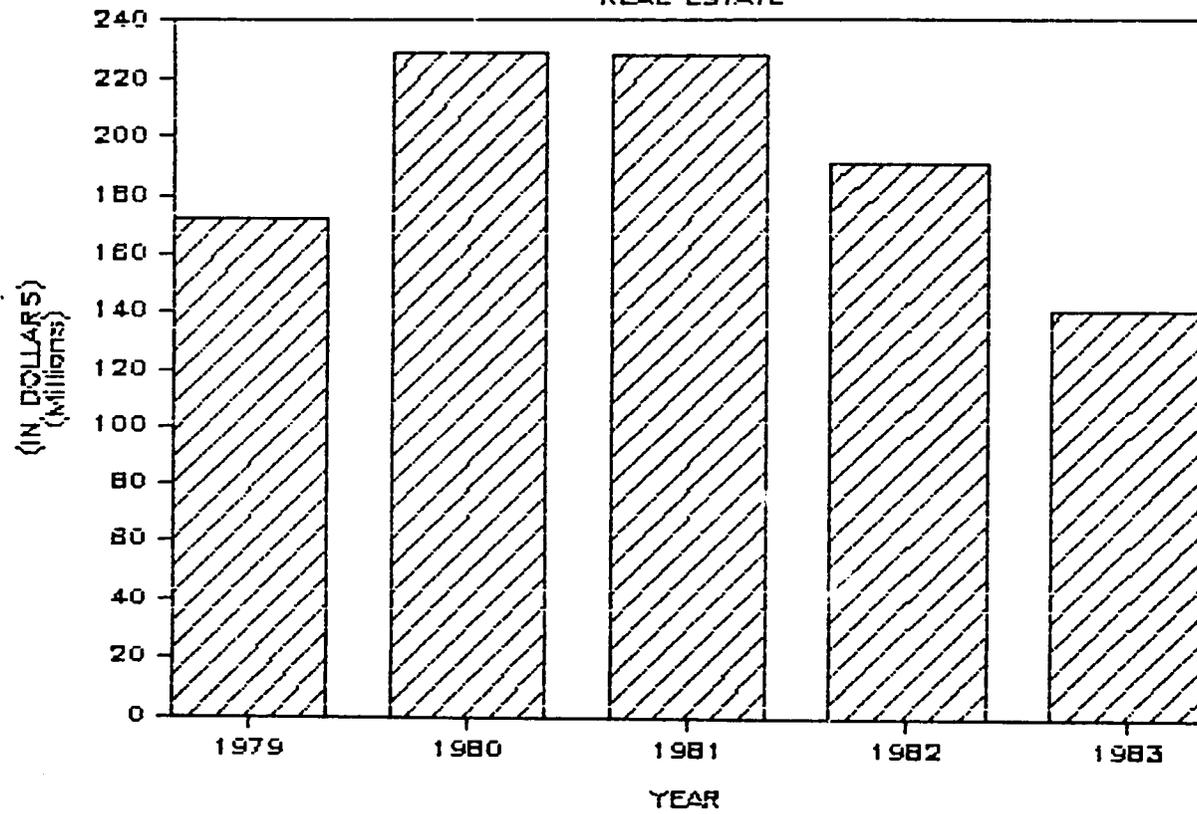
(IN DOLLARS)



GROWTH RATE OF THE BANKING, INSURANCE AND REAL ESTATE SECTOR



GNP FROM BANKS, INSURANCE AND REAL ESTATE



F. TAX SYSTEM

The Ecuadorian tax system is very complicated with many uncertainties, and it is often impossible to obtain a quick ruling from the tax authorities.

1. Tax authorities

- a) General Tax Administration (Direccion General de Rentas)
- b) General Customs Administration (Direccion General de Aduana)
- c) Provincial Collections Offices (Jefatura Provincial de Recaudaciones)
- d) Central Bank of Ecuador (collects export and import taxes)
- e) Municipal Councils (collects real estate taxes)
- f) Tax Tribunal

2. Corporate income tax rates (1981)

<u>Type of tax</u>	<u>Tax rate</u>
on undistributed profits	20%
on distributed profits:	
- for nationals	20%
- for foreigners	40%
on profits from foreign enterprise branches	40%
University tax	11%
on profits from the the Guayas and Manabi provinces	8%

3. Depreciation rate

Maximum rate is 20% per year for cars and agricultural tools. Machinery and building depreciation rates vary from as low as 2% to 10% per year.

4. Individual tax rate

- a) Maximum progressive income tax rate: 50%
- b) Proportional tax
 - o income in excess of \$120,000 from salaries or professional fees: 6%
 - o income arising from work in conjunction with capital (i.e., entrepreneurs, investors): 6%

- income from capital (dividends, interest and royalties): 18%
- c) University tax
- d) Tax on income from Guayana and Manabi provinces
- 5. Maximum inheritance and gift tax rate: 35%
- 6. Other taxes
 - a) Capital tax
 - b) Sales and service tax (value added tax)
 - c) Stamp tax
 - d) Municipal taxes (real estate, ect.)
 - e) Custom duties and export taxes
- 7. Tax incentives

The tax incentive system in Ecuador is extensive. The incentives cover various sectors such as industry, mining, agriculture, fishing, tourism and cottage industries.

G. ACCOUNTING

1. Accounting principles

Ecuadorian businesses accounting practices are mostly in accordance with the international accounting principles. Audit standards have not been clearly defined.

2. Books and records requirements

All medium and large businesses must keep the following books:

- general ledger
- general journal
- inventory book
- cash book
- movements of bank accounts
- auxiliary ledgers

3. Audited financial statements

Corporations and mixed economies are required to have independent auditors. These auditors must provide financial statements and their opinions on the companies' financial conditions to stockholders.

4. Accounting profession

a) Professional organizations

The National Federation of Accountants is the major professional organization. Each province has its own society referred to as a "colegio".

b) Professional training

Accounting certificates are awarded only after the successful fulfillment of required university courses and the completion of a university degree. No special exam is required for certification as a public accountant. Accountants must obtain annual licence, but the fee is nominal.

APPENDIX

Partial list of domestic commercial banks

Banco Continental
Banco de Guayaquil
Banco de Azuay
Banco del Pacifico
Banco Industrial y Comercial
Banco Sociedad General de Credito
Banco de Cooperativas del Ecuador
Banco de la Produccion
Banco de los Andes
Banco del Pinchincha
Banco de los Prestamos
Banco Internacional
Banco Popular del Ecuador
Filanbanco

Foreign bank branches

Banco Holandes Unido
Bank of America
Bank of London & South America
Citibank
Hollandsche Bank-Unie