

FN-ABC-394  
6/26/86

THE 1985-86 TRANSITION IN  
ECUADOREAN GRAIN PRICE AND MARKETING POLICIES--  
1986 PROGRESS

PREPARED FOR  
U.S. AID/ECUADOR MISSION

UNDER  
LETTER CONTRACT No. LAC-0051-C-00-6006-00  
SIGMA ONE CORPORATION  
SUBCONTRACT No. EPLT-3

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MAY 1986

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Summary

The Government of Ecuador (GOE) is undertaking five basic changes in its price policies to move toward free market competitive prices in agriculture. Major progress has been made toward each since the fall of 1985. These are:

- o end or sharply reduce reliance on official prices;
- o organize a nationwide, privately owned and managed system of storage facilities;
- o develop a private, national commodity exchange;
- o develop an orderly marketing strategy based on marketing loans, technical assistance, and a food security reserve system; and
- o develop a temporary price stabilization policy using purchases of certificates of deposit (CD) in the open market to avoid extreme price changes.

The new private commodity exchange (Bolsa Nacional de Productos Agropecuarios, S.A.) has begun operation and has adequate legal authorities, physical facilities, membership, organization, and staff for basic operations and long-term growth. The primary dangers to the success of the new Bolsa are:

- o Government policies that intervene inappropriately to attempt to establish prices that basic levels of domestic supply and demand cannot sustain.
- o Possible government involvement in the development of management policies of the Bolsa that lead buyers and sellers to use other markets rather than the Bolsa.

- o Possible commitments by the Bolsa to expensive services to the point that revenues from commissions cannot support them.

In extensive conversations with government officials and others during March and April 1986, including officials in the Bolsa, it is clear that the importance of these points is well understood. Nevertheless, it is also clear that political pressures both for government price policy intervention and for intervention in the Bolsa management and operations frequently become very strong, and will require continuing vigilance if they are to be avoided.

The tendency for the Bolsa to attempt to undertake expensive services is also powerful. Many proposed activities such as production forecasts and price projections are very valuable to Bolsa members. Nevertheless, these services will not provide direct revenues for the exchange and may be more properly the responsibility of the National Agency for Food Storage and Marketing (ENAC) or the Ministry of Agriculture. It will be very difficult for the Bolsa to limit its services to those it can afford, but such decisions could be fundamentally important to its long-run solvency.

It appears that the Bolsa is still struggling with the problem of defining criteria to insure that its Board of Directors is carefully balanced between the interests of buying and selling members, and focused precisely on the operations of the exchange to the virtual exclusion of other national or local policy issues. Again, the need is well understood. However, designing such criteria is difficult and will require continuing vigilance if it is to be done successfully.

The Ministry of Agriculture (MOA) has moved in two ways to change its price policies. It helped create the Bolsa and has widely informed producers and consumers about the new marketing system and its policy to rely on Bolsa

prices. At the same time, on April 12, 1986, ENAC announced prices at which it would buy certificates of deposit for hard corn and rice in the Bolsa. The announced prices, converted to the farm level, are roughly equivalent to the current official prices and 15 to 20 percent higher than those previously recommended.

In the current economic and political context, there are intense pressures for assurance by the MOA that market prices will be stabilized at or near official levels--prices designed to cover not only producer costs but a profit margin as well. In addition, the MOA is eager to avoid criticism of possible low prices in the new Bolsa which could undercut the shift to reliance on free markets. In addition, low or unstable prices are thought to reduce the willingness of banks to accept certificates of deposit as collateral for marketing loans. Thus, in an effort to support the overall new concept, a commitment to buy at high prices was made.

In spite of its logic, the decision has risk. Crops appear to be good in 1986. ENAC stocks are relatively large. The announced prices are likely to diminish demand and dampen demand growth relative to what it would have been had the MOA decided to stabilize prices only at levels based on variable costs of production. At those levels, ENAC likely would not have been required to buy any significant amounts, and price stimulated demand increases would have reduced stocks rapidly and strengthened prices later in the season.

In addition, the market prices would have increased the incentive to cut production costs and reduced the incentive to produce surpluses for 1987.

It now appears that the government intends to rely on a price policy very similar to that recommended in late 1985, except that minimum prices, reference prices, and release prices will all be higher than recommended.

And, while the higher levels pose some risk of large purchases and expenditures by ENAC especially during May and June 1986, these risks should diminish sharply during 1986 and 1987. By early 1987, if no further increases are made, growing demand and declining production incentives should mean market clearing prices above the current minimums.

An evaluation of current supply and demand projections for hard corn and rice implies substantial ENAC purchases through June 1986. Corn stocks are expected to be sufficiently large to keep pressure on prices through all of 1986, unless additional markets can be found outside Ecuador. Increasing demand should strengthen prices and permit ENAC CD sales perhaps by March 1987 (Tables 1, 2, and 3). The rice situation is somewhat more favorable, in spite of a relatively good crop. Consumption could exceed production in 1986, and permit the resale of ENAC stocks at favorable prices beginning late in the year.

These calculations imply relatively weak rice and corn markets buoyed by ENAC purchases through June 1986. However, they also project increasing prices by fall for rice, and in early 1987 for corn. ENAC would be required to spend perhaps S/366 million to support hard corn prices and S/521 million to support rice prices through mid-year, a total of S/887 million (\$5.9 million). However, in both cases, stocks likely could be sold later at higher prices so that ENAC could realize sales of S/954 million (\$6.4 million).

This outlook depends heavily on crop production in 1986. If production is higher than now expected (or consumption less), the pressure on prices and ENAC's risk will be much greater. In the opposite case, of course, the risk will be less.

Table 1. Ecuadorean Grain Production 1/

Crop	1984	1985	1986	Change
	-- thousand metric tons --			percent
Rice (cascada)	459	468	463	-1
Corn	280	297	292	-2
Soya	57	77	58	-25
Sorghum	5	8	18	125

1/ Fieldweights. Commercial net weights for 1986, excluding seed, are: milled rice, 222 tmt; corn and sorghum, 263 tmt; and soya, 52 tmt, based on ENAC projections.

Source: MOA.

Table 2. Hard Corn and Sorghum: Production-Consumption Balance and ENAC Operations, 1986

Month	Production	Consumption	Balance	ENAC Operations		
				Purchase 1/	Cost	Stocks
-- thousand metric tons --					(mil S)	(tmt)
Beginning			65.0			45.0
April	29.7	20.0	74.7	2.0	50.49	47.0
May	60.2	20.1	114.8	7.5	189.32	54.5
June	80.9	20.1	175.6	5.0	126.21	59.5
July	31.4	20.2	186.8			59.5
August		20.2	166.6			59.5
September	11.0	20.3	157.3			59.5
October	18.5	20.3	155.5			59.5
November	23.6	20.4	158.7			59.5
December	7.7	20.4	146.0			59.5
January		20.5	125.5			59.5
February		20.5	105.0			59.5
March		20.6	84.4	-15.0	-492.23	44.5
Exports		20.0				
Total	263.0	263.6			-126.21	

1/ Purchases of CDs in the Bolsa at announced prices. Sales in the Bolsa at the ENAC minimum, 1.30 percent of the minimum.

Source: MOA.

**Table 3. Milled Rice: Production-Consumption Balance  
and ENAC Operations, 1986**

Month	Production	Consumption	Balance	ENAC Operations			
				Purchase 1/	Milled	Rough	Cost
-- thousand metric tons --						(mil S)	(tmt)
Beginning			20.4				10.4
April	15.9	20.0	16.3	3.0	4.8	149.00	13.4
May	39.7	20.1	35.9	7.5	12.0	372.49	20.9
June	56.9	20.1	72.7				20.9
July	19.9	20.2	72.4				20.9
August	9.9	20.2	62.1				20.9
September	31.4	20.2	73.3				20.9
October	35.0	20.3	88.0				20.9
November	8.9	20.3	76.6				20.9
December	4.5	20.3	60.8	-2.0	-3.2	-129.13	18.9
January		20.4	40.4	-7.5	-12.0	-484.24	11.4
February		20.4	20.0	-11.4	-18.2	-736.04	0
March		20.4	-0.4				
Imports	15.0						
Total	237.1	242.9		-10.4	-16.6	-827.92	

1/ Purchases of CDs in the Bolsa at announced prices. Sales in the Bolsa at the ENAC minimum, 1.30 percent of the minimum.

Source: MOA.

The presence of these risks does not, by itself, jeopardize the new Bolsa. It does increase the likelihood of large and continuing intervention by ENAC, and of market clearing prices lower than ENAC announced levels and a corresponding reluctance by sellers to trade at such prices. At best, they imply a period when the market is undergirded by ENAC's announcements and trading is flat at about those prices for some time. Until that period passes and private trade at levels above the ENAC offers dominates most of the trading, the Bolsa will function with some difficulty. If subsequent increases in ENAC offer prices were made, they would increase that period and the attendant risks.

### Background

The Government of Ecuador has decided to restructure its agricultural policies so as to be able to depend on domestic free market prices by 1990. Toward that end, it is undertaking a series of changes in policies and helping create institutions to facilitate the longer run transition from administered prices to free marketing (Chart 1). This paper is based on a series of studies of Ecuadorean price policy in 1985 and on personal observations and conversations with government officials during March and April 1986.<sup>1</sup> It depends heavily on the detailed analysis of grain price policy options done in October 1985 and subsequent recommendations made in December 1985 and still under consideration by officials of the GOE and USAID.<sup>2</sup>

The report focuses on the progress being made in implementing the transition to a free market in Ecuador given the constraints imposed by the current economic and political context.

It was recommended in late 1985 that the GOE undertake several interrelated policy actions to initiate the transition to a free market:

- o End the policy of official prices and market intervention.

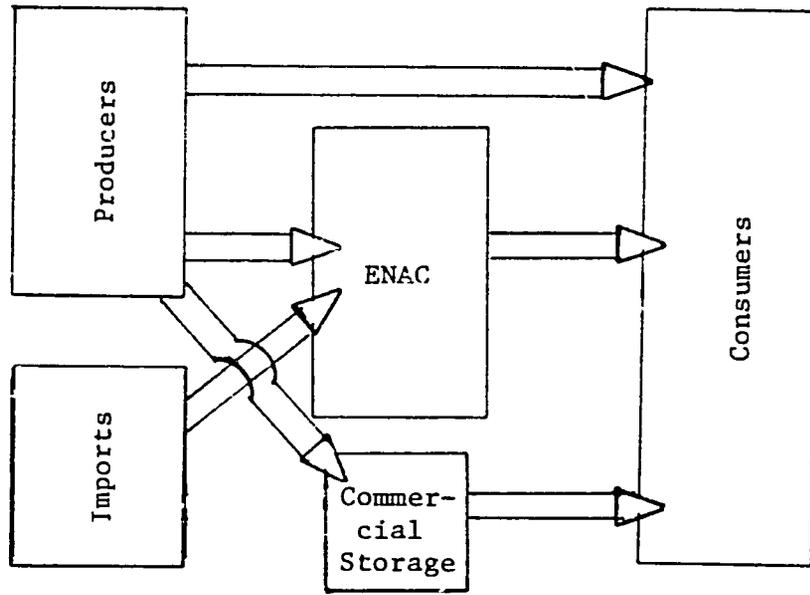
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1 A trip schedule and list of persons contacted can be found in Appendix A.

2 Economic Perspectives, Inc., Grain Pricing Policy in Ecuador, done in collaboration with Sigma One Corporation for the Ministerio de Agricultura y Ganaderia, Unidad de Analisis de Politicas Agricolas under USAID Contract No. LAC-0005-C-00-5091-00, October 1985.

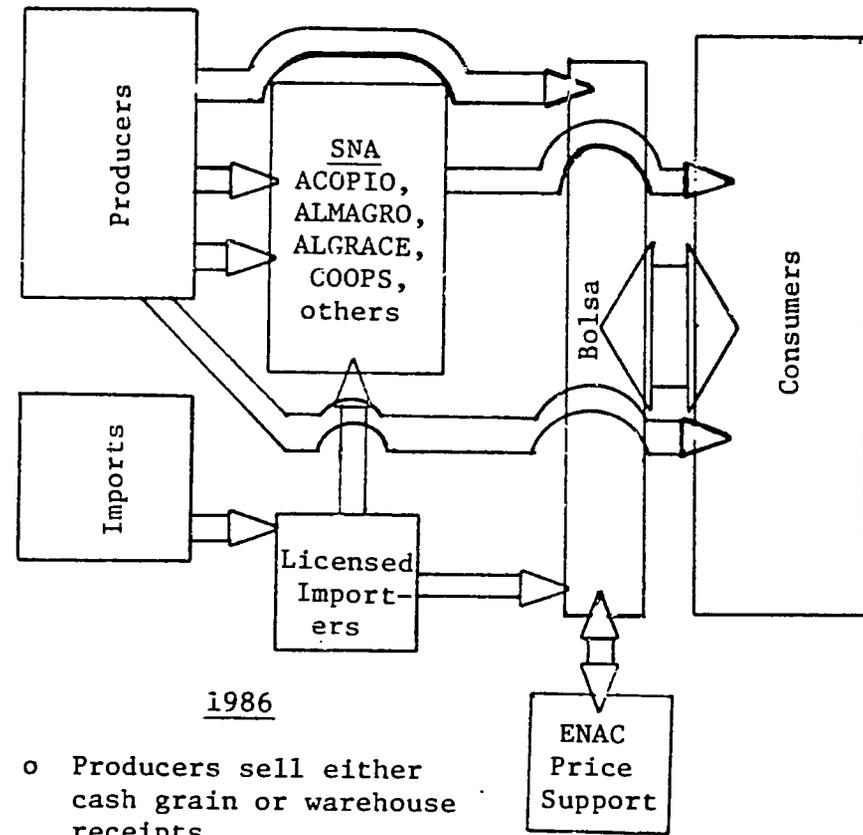
Also, The 1985-86 Transition in Ecuadorean Grain Price and Marketing Policies, prepared for USAID, Quito, Ecuador under Work Order No. 518-6-041-6, December 1985.

Chart 1. Ecuadorean Grain Marketing System



1985

- o System limited to cash transactions
- o Transactions based on inspection of individual lots



1986

- o Producers sell either cash grain or warehouse receipts
- o SNA--commercial warehouses--sell either cash grain or warehouse receipts
- o ENAC price support--only warehouse receipts

- o Organize a nationwide, privately owned and managed storage system to include facilities previously owned by ENAC. ENAC's direct purchase, storage, and other market operations should be ended.

ENAC, or some subsequent administrative entity, should continue to carry out a range of market support programs.

--Supervise markets. Check scales and weights, measures, and grades used in grain marketing; assist in training of private graders; and inspect and audit both warehouses issuing official warehouse receipts and facilitates issuing bills of lading.

--Review the overall operation of the marketing system, including transportation charges and costs of other services including commercial storage and grain drying. Particular problems would be identified and specific, limited steps to increase competition and efficiency proposed.

--Publish estimates of current crop production, prices, sales, storage amounts, prospective plantings, crop conditions, and daily market news reports about prices and quantities sold.

--Operate a number of small buying stations in rural areas, offering market prices (national prices adjusted to local areas) in order to increase market competition.

- o The GOE should help commodity traders organize a private, national exchange, supervised by the Minister of Agriculture (MOA), for the trading of a broad range of agricultural products. The exchange should be a civil, nonprofit corporation patterned along the lines of those in Colombia, Brazil, and Argentina.

In addition, the GOE should insure that market prices are published widely so as to provide a basis for planning and investment throughout the sector.

- o Develop an orderly marketing strategy with several elements.
  - Marketing loans. Commercial credit from BNF and private banks should be made available to farmers who own grain in storage so they can hold grain seasonally past harvest-time low prices at the same time they are preparing to produce the following crop.
  - Construction loans. Credit for private storage facilities, especially small units in rural areas.
  - Technical assistance to help producers learn to store and market grain in order to take advantage of seasonal price patterns.
  - A food security system. The government should purchase warehouse receipts for basic commodities and maintain these amounts in storage until prices reach specified release levels. For wheat, hard corn, sorghum, rice, and soybeans, a security reserve of about one month's consumption should be maintained to offset possible supply interruptions.
- o The GOE should undertake a temporary price stabilization policy for basic commodities, with stabilization minimums for rice, hard corn, and soybeans and reference and release prices for selected other crops to regulate imports and government stocks.

For other basic crops and commodities, the GOE could review price levels and trends at farm, wholesale, and retail levels and would levy import duties but not attempt to regulate imports or stabilize domestic prices.

Overview

By April 1986, several of the most important recommendations are in the process of being implemented in the transition to a free market. The nation's grain storage sector has been reorganized into a system of private warehouses (Almacopio). Facilities formerly owned by ENAC are being transferred to the management and ownership of the new organization. Almacopio is preparing to provide necessary marketing services, and to issue negotiable warehouse receipts which can be traded on the new Bolsa.<sup>3</sup>

At the same time, a new private commodity exchange--the Bolsa Nacional de Productos Agropecuarios--has been organized and is in operation.

The Bolsa was designed closely along the lines of the commodity exchange operated in Bogota, Colombia. In October 1985, a team of Ecuadorean and USAID officials visited exchanges in Colombia, Brazil, and Argentina, and recommended that a Bolsa be established in Ecuador roughly along the lines of the Bogota Bolsa, but with several important differences. In late 1985, a manager (Econ. Juan Zevallos Chevasco) was named to organize a private Bolsa in Ecuador. He and others visited the Bogota Bolsa, and that exchange sent several staff members to Ecuador to help design the new Bolsa and train Ecuadorean staff. During April 1986, four different staff members from Bogota scheduled extensive periods in Ecuador to help with training.

The GOE placed a very high priority on having the Bolsa operational in early 1986. Both GOE and USAID staff were requested to assist in several

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<sup>3</sup> Marketing services are evolving, with priorities given to those essential for trading on the Bolsa. Commercial grades have been defined, and weighing services provided to support the market. Efforts to improve these services, and to provide estimates of production and consumption, prices, and outlook are underway.

capacities, including development of procedures and policies and support facilities including computer software packages to maintain Bolsa records. The exchange began operating April 25, 1986.

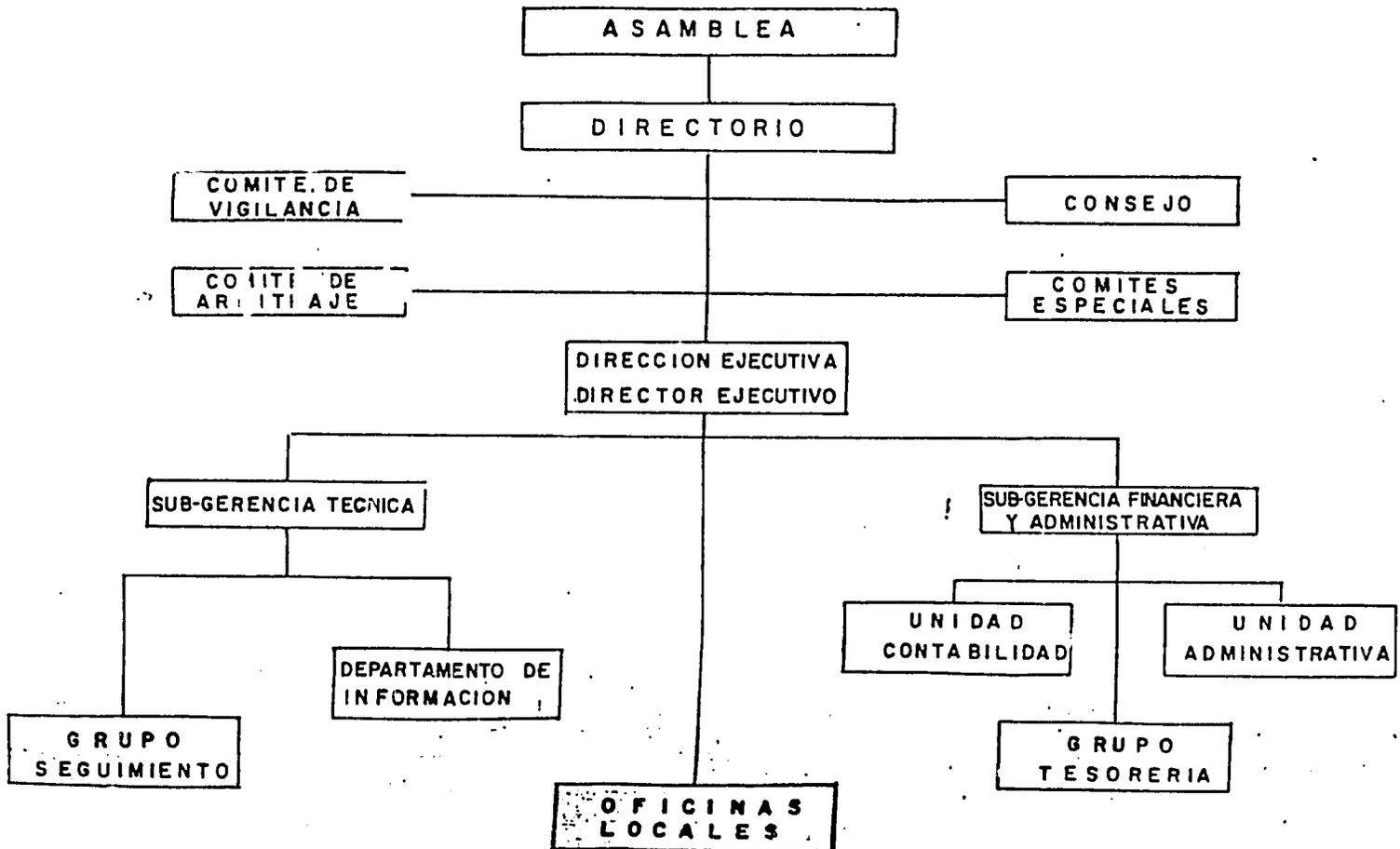
#### A Review of the Ecuadorean Bolsa

The new Bolsa is organized under statutes issued January 3, 1986, with operating regulations issued soon thereafter. It is physically located in Guayaquil in a building renovated to its needs. Initial organizational steps after designing the civil, nonprofit corporation were to solicit membership, accredit trading members, and publish trading procedures. The initial phases of these steps are complete.

In a series of meetings with officials of the Ministry and those of the Bolsa, an overview evaluation of the development of the Bolsa was made in six categories:

- o Overall organization: National statutes, regulations, operational procedures, contracts, membership, and membership rules (Chart 2).
- o Operational policy and policy review: The board of directors, its make-up, operational committees, and operating procedures.
- o Management of the exchange: Executive staffing patterns, staff levels, procedures, and rules.
- o Physical facilities.
- o Market operations: Trading procedures, organization of brokers and traders and procedures to buy or sell on the exchange, including public information and data flows regarding market supply and demand.
- o Auxiliary service: Grades, standards, banking services, transportation and storage, and other facilities.

Chart 2. Bolsa Nacional de Productos Agropecuarios, S.A.



The Bolsa is patterned very closely after the commodity exchange in Bogota, and initially will include many of the shortcomings of that exchange. For example, each offer to buy and sell must specify several characteristics including location, lot size and grade, price offer, sale date, and one or several payment terms. Bolsa officials and those in the Ministry are aware that the use of more standardized contract terms is common in modern markets and that such complex contracts will both limit the number of trades that can be made in a busy trading session and increase the difficulty of interpreting prices since prices on the Bolsa may differ because of differences in location or terms, as well as in response to changes in supply or demand.

Nevertheless, they choose the more complex system initially for at least two reasons. They believed that a system that permitted direct negotiation of several terms of sale rather than only prices would build confidence in the system, since final price negotiations would be more transparent. And, they believed that the system could be simplified as necessary.

The Bolsa is designed to be self-governing and self-modifying. Since membership on the policy subcommittees of the Board of Directors gives those who buy and sell on the Bolsa the power to change rules that unnecessarily inhibit trading efficiency, the Bolsa can be expected to review trading operations almost constantly, especially at the beginning, and modify procedures that are unnecessarily cumbersome. Thus, if the complex contracts prove to limit trading, simplified contracts like those used on other Latin American markets and in the United States can be recommended and implemented.

This observation highlights the importance of the Board of Directors of the Bolsa. Such a Board is the primary policymaking body of any civil corporation but must be especially powerful in a well managed commodity exchange.

Buyers and sellers can always buy and sell outside an exchange that does not work well. Thus, the Bolsa must provide an environment that serves the trade, otherwise it will not be used. Such a policy environment requires that all policy recommendations be worked out carefully by balanced committees of buyers and sellers who have practical and intimate knowledge about the way the exchange must work if it is to be efficient. Not only must these policy committees be able to develop balanced policy recommendations, but they must be confident that the Board of Directors will use its power to insure that

such decisions are implemented. In the absence of such confidence, the trade will abandon the exchange.

Because the Board of Directors is so powerful, it must be extremely well balanced so that its power is both focused and constrained. It is not uncommon for boards of commodity exchanges to be divided not only into seats representing buyers and those representing sellers, but into buyers and sellers of individual commodities. In active exchanges, these requirements are well known and understood, and the subcommittees that recommend candidates for vacant seats select candidates with great care so as to preserve the balance.

These restrictions apply to the main body of the Board, but not to the outside or public members who frequently are bankers, university professors, transportation executives, or others selected for their affiliation or their expertise.

Since the business of the Bolsa is the purchase and sale of commodities, and, more specifically, the perfection of trading facilities and arrangements that will facilitate such sales, it is dangerous to elect any member who may be strongly interested in another purpose--a representative of a producer group, for example, who has an overriding interest in holding prices high (in spite of supply or demand) or a representative of a consumer or user group whose primary interest is low prices. Such groups are often unsatisfied with the operation of a free market, and frequently propose interventions of one kind or another, steps that could have a damaging impact on the operation of the Bolsa and lead to its demise.

The Bolsa is operating now with a provisional Board of Directors, and is preparing to elect its first "permanent" full board.<sup>4</sup> Among the candidates are producers, buyers, and others, affiliations that could pose a threat to objective balance of the Board. Both officials of the Ministry and the Bolsa indicate that they are fully aware of the need to balance and limit membership of the Board primarily to trading members. Nevertheless, the temptation to balance the Board politically and have the government maintain a powerful presence is strong. Violation of this principle could have very serious long-term consequences.

In the initial stage of its operation, the Bolsa is operating with funds from USAID and from the Ministry. It will derive revenues from the sale of seats on the exchange, and from commissions charged for each transaction (see Appendix B for an estimate of cash flow for the Bolsa). The manager of the Bolsa expects a total deficit of only S/24 million by 1988, with a positive annual cash flow. For the Bolsa to achieve this target, it projects that in its third year of operation it will market 10 percent of the paddy rice, 20 percent of the milled rice, 20 percent of the hard corn, and 50 percent of the soybeans will be sold through the Bolsa. These sales are projected to yield a

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<sup>4</sup> Candidates for positions on the Board of Directors in April 1986 are:

<u>Productores</u>	Ing. Francisco Cucalon Baluarte Sr. Kleber Rodriguez Manzo Sr. Tulio Reyes Murgueitio
<u>Compradores</u>	Sr. Jose Chiriboga Acosta Sr. Luis Bakker Dr. Juan Falconi
<u>Miembros Sociales</u>	Ing. Jose Nebot Saadi Eco. Modesto Correa

flow of S/50,123. To operate the Bolsa will cost an estimated S/32 million for salaries and benefits, and S/18 million in other costs.

At this early stage, it is not possible to know whether the estimates of sales through the Bolsa, and thus operating revenues, are feasible or not, since there is no experience in Ecuador with such a market to serve as a guide. Clearly, the Bolsa will attempt to maximize sales and commission revenues. However, the Bolsa's primary problem is likely to be to limit expenses. It plans a series of ambitious activities, many of which could be quite costly. For example, the Bolsa appears to be planning to undertake not only situation and outlook reporting for basic crops, but crop production and marketing surveys. Some of the Bolsa's information gathering and publication efforts appear to duplicate those planned by Almacopio, ENAC, and MOA. It will be necessary to organize these efforts carefully if the Bolsa's expenses are to be controlled.

#### Changes in Price Policy

Price administration is done in two ways in Ecuador. For many food and agricultural products, official prices are established at farm, wholesale, and retail levels by the Frente Economico, a government wide economic policy committee. The Ministry of Agriculture (MAC) is a member of the committee and is given primary responsibility for the designation of official prices for agricultural products (Table 4). Price enforcement is the responsibility of provincial governments, who generally do little to insure that market prices conform with the law.

In addition, two parastatal corporations intervene directly in farm and retail markets. ENAC has the responsibility to purchase selected commodities in order to establish minimum farm prices, and the National Agency for Retail

Food Sales (ENPROVIT) sells a number of retail food products through a chain of its own stores to enforce retail price maximums.

Not only are the administered prices above world price levels, but they appear to be above market clearing levels as well. As a result, ENAC's purchases of rice and corn have been large, and have resulted in very large carryover stocks of ENAC owned products and high operating costs. Going into the 1986 harvests, ENAC stocks of hard corn and milled rice total more than 55,000 metric tons, enough to fill about one-half of total public storage space.

**Table 4. Official Prices in Ecuador, Producer Level**

Item	Price	Date Established
<u>Rice</u> Tipio Largo 20% H; 5% I	S/2,400 90.72 kgs	April 17, 1985
Tipio Extra Largo 20% H; 5% I	S/1,224 45.36 kgs	April 17, 1985
Tipio Medio 20% H; 5% I	S/1,176 45.36 kgs	April 17, 1985
<u>Maize</u> <u>Duro</u> 20% H; 3% I	S/1,000 45.36 kgs	April 17, 1985
<u>Soya</u> 12% H; 3% I	S/1,680 45.36 kgs	Sept. 10, 1985

Source: Ministry of Agriculture.

Price Stabilization Policy Recommendations of 1985

For four commodities--hard corn, rice, soybeans, and sorghum--it was recommended that the government undertake a stabilization program to prevent unnecessarily wide swings in domestic prices, and to gradually align domestic and international prices, a major change away from administered prices for

those crops. It was further recommended that for crops that are primarily imported such as wheat and barley, prices would be regulated entirely by trade policies.

By 1990, the price stabilization program would be ended for all crops and commodities.

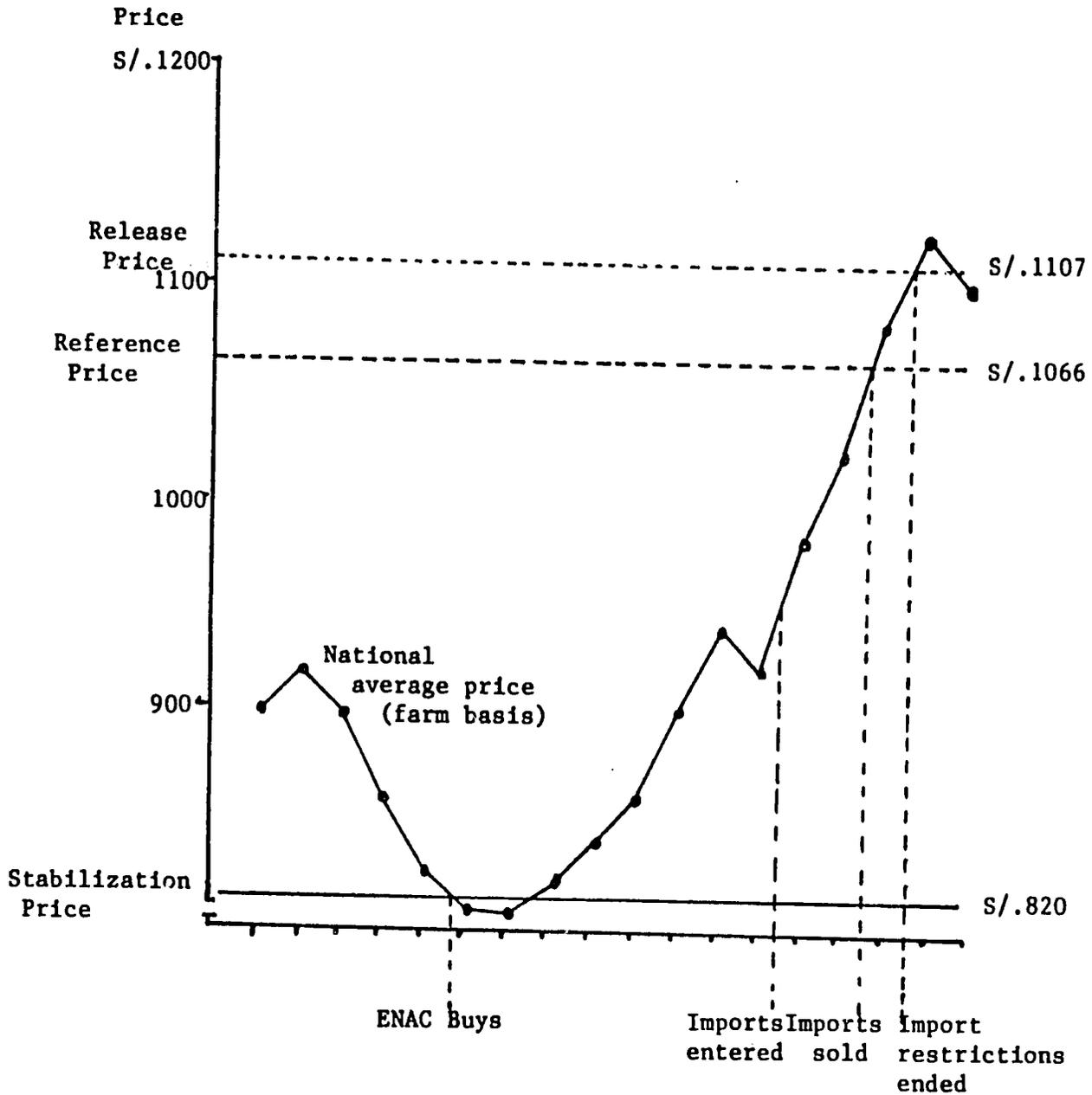
To implement the transition policy for the four domestic food crops, it was proposed that the government define a stabilization price minimum on the basis of the variable cost of production (Table 5 and Chart 3). This approach would differ from past policy in several important respects. First, official prices were established to cover total costs of production plus a markup of approximately 30 percent for "profit," i.e., and to guarantee producers recovery of all costs (variable and fixed) plus a net return. Second, they were not minimum price targets but administered price levels. The third difference is that while ENAC was unable to guarantee the official price because it lacked both financial and physical capacity, it would be able to protect proposed price minimums since the free market is expected to establish prices most of the time and require only occasional intervention to stabilize prices.

**Table 5. 1986 Price Structure, Selected Crops**

Crop	Stabilization Target	Reference	Release
		-- S/. qq --	
Corn	820	1,066	1,107
Soybeans	1,400	1,820	1,890
Rice (Paddy)	1,050	1,365	1,418
Sorghum <u>1/</u>	730	949	986

1/ 90 percent of corn.

Chart 3. Transition Policy Example, Hard Corn, 1986



- o Stabilization minimum - variable cost of production.
- o Reference price - 130 percent of minimum.
- o Release price - 135 percent of minimum.

Chart 3 indicates the way a price stabilization program might be operated.<sup>5</sup> The chief characteristic of such a program is that the market operates without intervention as long as prices remain in a relative broad range. Import sales and price support activities would be strictly limited to periods when prices were either above the reference price, or below the stabilization minimum.

For the stabilization policy to be effective, it must be accompanied by a consistent trade policy. Imports and exports would be purchased and sold by private traders at world prices, even though the government continues to license and regulate trade.

- o A reference price would be established for each commodity at 130 percent of the stabilization price minimum. Imports would be sold only at prices above that level. A variable levy would be charged, based on the difference between the import price paid and the reference price in order to provide some protection for domestic producers.
- o The amount of imports to be licensed would be announced annually, based on estimates of domestic production and consumption at the reference price. Imports would be licensed and scheduled on the basis of seasonal price estimates. Imports may be entered and stored when market prices reach 115 percent of the minimum, and sold when prices reach 130 percent.

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<sup>5</sup> A grain reserve was recommended to be equal to one month's consumption, a total of just over 90,000 tons of rice, wheat, hard corn, soybeans, and sorghum.

- o To insure imports move to market as needed, licenses would have an expiration date 21 days after prices reach 130 percent of the stabilization minimum.
- o The government would remove import restrictions when prices reach 135 percent of the stabilization minimum. At this level, the government may also release the security reserve by selling CDs.
- o Export licenses also would be issued on the basis of estimated national production and needs (at the reference price). Exports will be made by private traders at world market prices, and may be encouraged by tax concessions.

#### Current Economic Situation in Ecuador

Based on conversations with officials of USAID, the Ministry of Agriculture, and others in March and April 1985, the GOE remains committed to move to free market-oriented policies as quickly as possible. However, the nation now faces growing economic pressures.

Ecuador's 1985 economic performance was impressive. Real gross domestic product grew 3.2 percent, and real per capita GDP grew 0.4 percent. Oil production increased almost 8 percent to reach an average of 280,586 barrels per day, of which an average of more than 64 percent was exported. Government fiscal policies created an overall public sector surplus equal to approximately 2 percent of GDP. The combined effect of the government's fiscal and monetary policies was to reduce the inflation rate to 24.4 percent.

The progressive devaluation of the sucre, begun in September 1984, was completed in November 1985. In January 1986, the government issued a new tariff schedule which significantly reduced protection afforded local industry. Effective March 19, banks and financial institutions gained limited

authority to make readjustable interest rate loans and pay adjustable rates on deposits.

Nevertheless, the outlook for 1986 is bleak. Oil prices declined dramatically during the first quarter. U.S. Embassy analyses indicate that even if oil production and exports increase as projected, Ecuador will lose over \$580 million if the price of oil averages \$15.00/bbl this year, more if the price is lower. The fall in export earnings will cause serious balance of payments difficulties, a fiscal deficit, and may produce negative real GDP growth.

In 1985, Ecuador's inflation rate, as measured by the urban consumer price index was 24.4 percent, slightly lower than 1984. In December 1985, the rate was 25.1 percent, and for the year ending February 28, 1986, was 22.4 percent.

An August 29, 1985 the government transferred the last remaining current transactions from the official exchange rate (buying \$1 equals S/66.5, selling \$1 equals S/67.85) to the Central Bank intervention rate (buying \$1 equals S/95, selling \$1 equals S/96.5) thereby completing the defacto devaluation of the sucre. On November 12, the government issued the decree devaluing the official exchange rate to buying \$1 equals S/95, selling \$1 equals S/96.5

Falling oil prices compelled the GOE to devalue the sucre again on January 28, 1986. The new Central Bank intervention exchange rate (buying \$1 equals S/108.5, selling \$1 equals S/110) represents a 14 percent devaluation from the old official rate. The old rate still exists, but is used only for the Central Bank's internal accounting; all current transactions use the new intervention rate.

Under pressure from falling oil prices, the sucre depreciated dramatically in the free foreign exchange market during the first 3 months of 1986. The dollar peaked at buying \$1 equal S/165.00, selling \$1 equals S/167 in February. Currently, private banks uniformly are quoted a buying \$1 equals S/140, selling \$1 equals S/141 exchange rate; exchange houses offer only a slightly higher rate (buying \$1 equals S/142.5, selling \$1 equals S/144).

Economic Outlook for Agriculture

Ecuador faces its third successive large harvest of hard corn and rice in 1986. Based on early indications from the April-July harvest, rice production will be slightly larger than 1985's large crop and corn production will be nearly as great.

As a result of good crops and large beginning stocks, grain prices will face substantial pressure for much of the year. The continuing growth of agricultural production as well as estimates of production cost prepared by the Ministry of Agriculture indicate that current price support levels (and prices) for corn, soybeans, and rice provide a strong economic incentive for production and a disincentive for consumption.

Official prices were last revised in April 1985 for corn and rice and in October 1985 for soybeans, and continue in effect until superseded or revoked.

Continuing inflation and the falling value of the sucre tend to bring the official prices more closely in line with world prices, although the gap is still wide.<sup>6</sup> For example, the world price of corn is just over \$100 per ton FOB major export ports. The S/1,000 per qq farm level official corn price in Ecuador is equivalent to a market price of about S/1,145, or \$260 per ton at last summer's S/97 per dollar. However, at S/150 per dollar, the S/1,145 rate is about \$168 per ton. It is still well above the \$119 per ton (\$3.03 per bushel) price and income support rate in the United States.

While the GOE has not specifically revoked official prices, it is de-emphasizing them. The government is considering a decree that would clarify the role of official prices versus those determined in the Bolsa, but as of

---

<sup>6</sup> World grain prices are not only low but falling in response to sharp reductions in price support levels for U.S. 1986 crops.

late April such a decree has not been approved or issued. The government is widely publicizing the new marketing system and the opening of the new Bolsa and ENAC has said that it will buy rice and corn in the Bolsa at market prices roughly equivalent to the official farm level prices. While this may not be a government commitment to support prices, the result has been stronger farm prices during the last two weeks.

The result is a modified policy in which prices are determined in the Bolsa, much as was recommended earlier. However, the range in which the free market can determine grain prices would be somewhat higher than anticipated since the purchase prices announced by ENAC are higher than the earlier recommendations.

There is some danger, of course, that the higher prices will be expensive to support, will dampen consumption and provide incentives for further surplus production in subsequent years. Each of these concerns is examined in some detail in subsequent sections.

There is some likelihood that ENAC can develop special markets for part of its surplus corn outside Ecuador at favorable prices. To the extent this can be done, it will relieve pressure on internal markets and reduce ENAC's losses from price support operations. Nevertheless, the surpluses involved are large and exports large enough to significantly reduce current stocks plus potential purchases would need to be unusually large.

The implicit policy now evolving appears to have the same elements as recommended earlier. The stabilization reference prices would be the highest levels ENAC would support with direct market purchases--at higher prices, ENAC would not buy in the Bolsa, except possibly to build a security reserve.

The key price level in the system continues to be market minimum--levels at which ENAC would buy stocks. Levels at which ENAC would sell would be 130 percent of this level, and the release price level would be 135 percent (Chart 4).

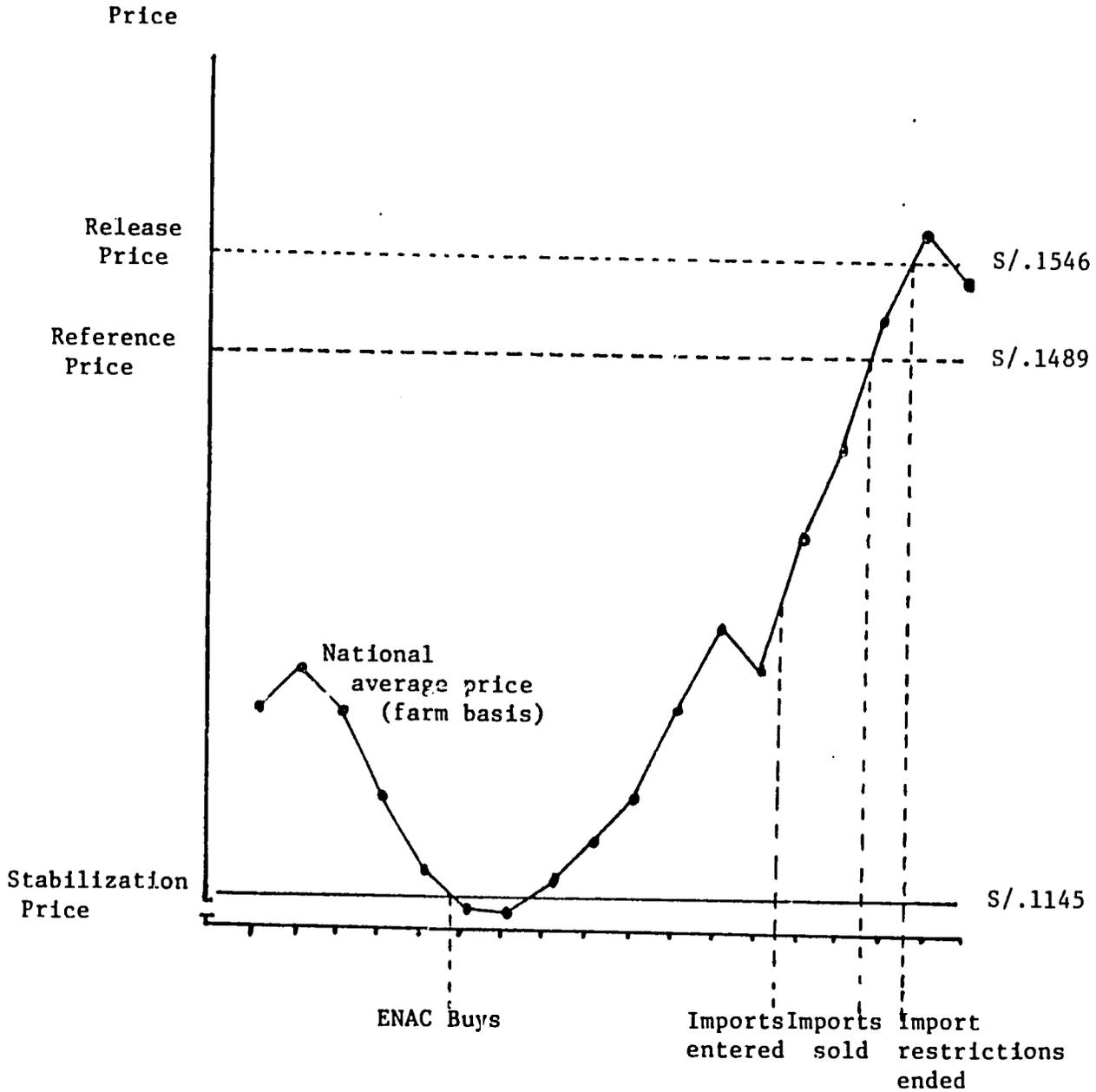
**Table 6. 1986 Price Structure, Selected Crops**

Crop	ENAC Purchase Prices (Market Level)	Implied ENAC or Import Sales Price	Food Security Release
	1,145	1,489	1,546
Corn	1,408	1,830	1,901
Rice (Paddy)			

Chart 4 indicates the way the modified price stabilization program implied by current policies might be operated. Imports and exports would be purchased and sold by private traders at world prices, even though the government continues to license and regulate trade.

- o A reference price would continue to be established for each commodity at 130 percent of the minimum. Imports would be sold only at prices above that level. A variable levy would be charged, based on the difference between the import price paid and the reference price in order to provide some protection for domestic producers.
- o The amount of imports to be licensed would be announced annually, based on estimates of domestic production and consumption at the reference price. Imports would be licensed and scheduled on the basis of seasonal price estimates. Imports may be entered and stored when market prices reach 115 percent of the minimum, and sold when prices reach 130 percent.

Chart 4. Modified Transition Policy Example, Hard Corn, 1986



- o Stabilization minimum - S/.1145.
- o Reference price - 130 percent of minimum.
- o Release price - 135 percent of minimum.

- o To insure imports move to market as needed, licenses would have an expiration date 21 days after prices reach 130 percent of the minimum.
- o The government could remove import restrictions when prices reach 135 percent of the stabilization minimum. At this level, the government may also release the security reserve by selling CDs.
- o Export licenses also could be issued on the basis of estimated national production and needs (at the reference price). Exports will be made by private traders at world market prices, and may be encouraged by tax concessions.

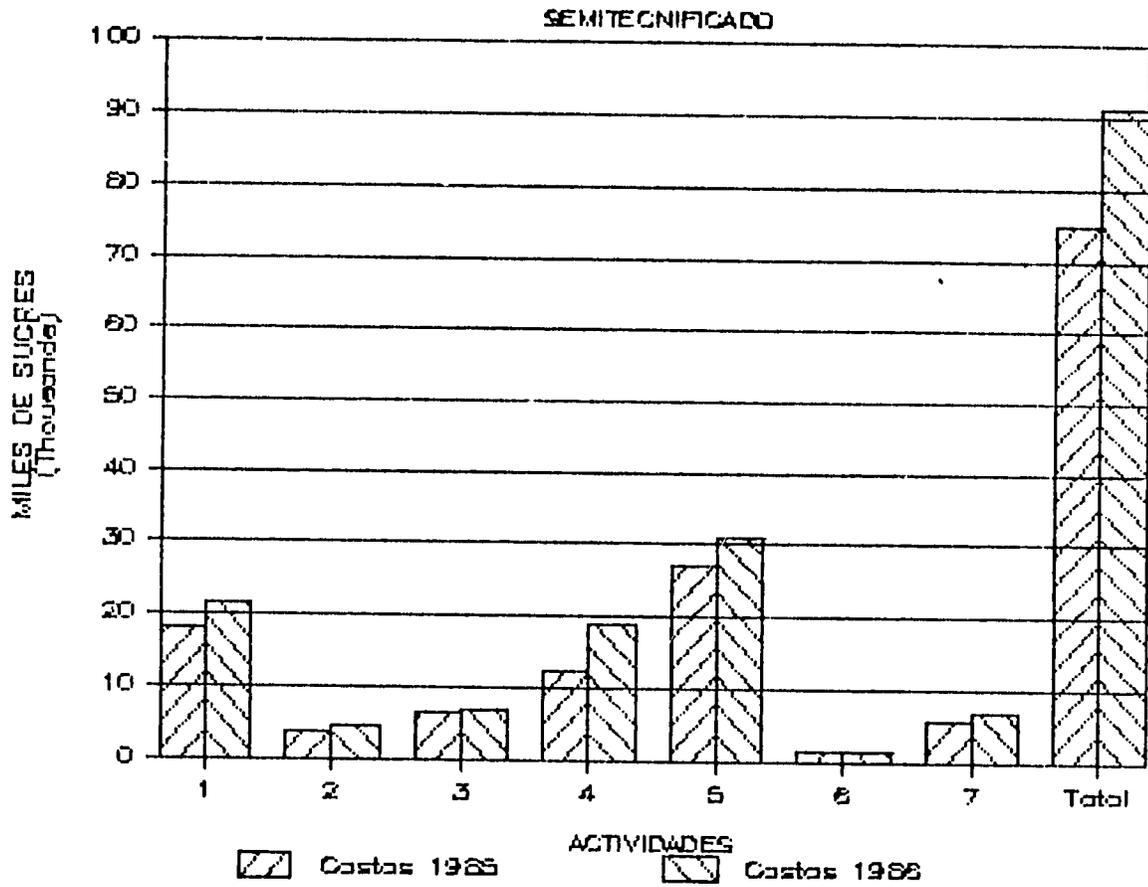
Impacts of the Transition Policy in 1986

While the ENAC purchase minimums, if enforced, are likely to be high enough to dampen demand, continuing inflation at the 24 percent annual rate would be expected to mitigate this impact rapidly during 1986. Thus, if ENAC supports the announced levels early in 1986 and does not increase price minimums through the year, some demand strength should be apparent by fall.

Similarly, the ENAC supported price incentives are likely to provide strong production incentives through 1986, but to be weakened in 1987 by increases in cost of production. In spite of declines in world prices of fertilizer and some other chemicals in 1986, direct costs of production increased 19 percent for corn, 17 percent for soybeans, and 22 percent for technified rice production (Charts 5, 6, and 7). Similar increases in 1987 would mean that even if ENAC guarantees prices at the levels currently announced, corn and soybean production would be expected to be relatively stable and rice production continue to grow as increased irrigated land becomes available. MOA expects 175,000 hectares to be planted to rice in 1987, up from 173,600 in 1986.

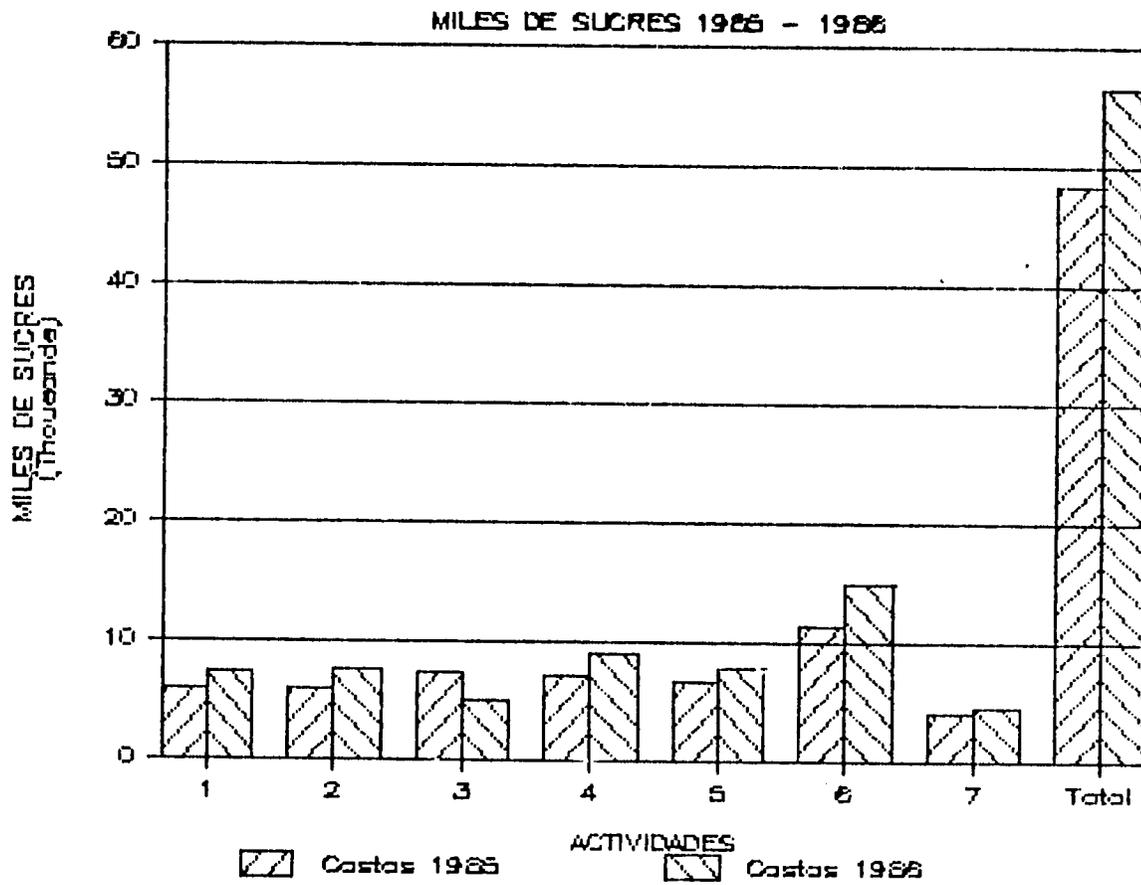
It is, of course, too early to know what the 1986 harvest will prove to be, and far too early to estimate 1977 crops. Several projections of 1986 crops have been made by ENAC, Almacopio, the Bolsa, and by the national rice, corn, and soya programs in MOA. These estimates frequently cover different time periods and are made on different bases. Nevertheless, the outlook as of mid-April 1986 appears to be as follows:

Chart 5. Cost of Production of Rice



1	MANO DE OBRA	18250	21490
2	SEMILLAS	3750	4546.5
3	FERTILIZANTES	6300	6900
4	FITOSANITARIOS	12240	18874.5
5	MAQUINARIA Y EQUIPOS	27075	30782.5
6	OTROS	1500	1600
7	IMPUESTOS	5598.31	6819.67
Total	TOTAL	74713.31	91013.17

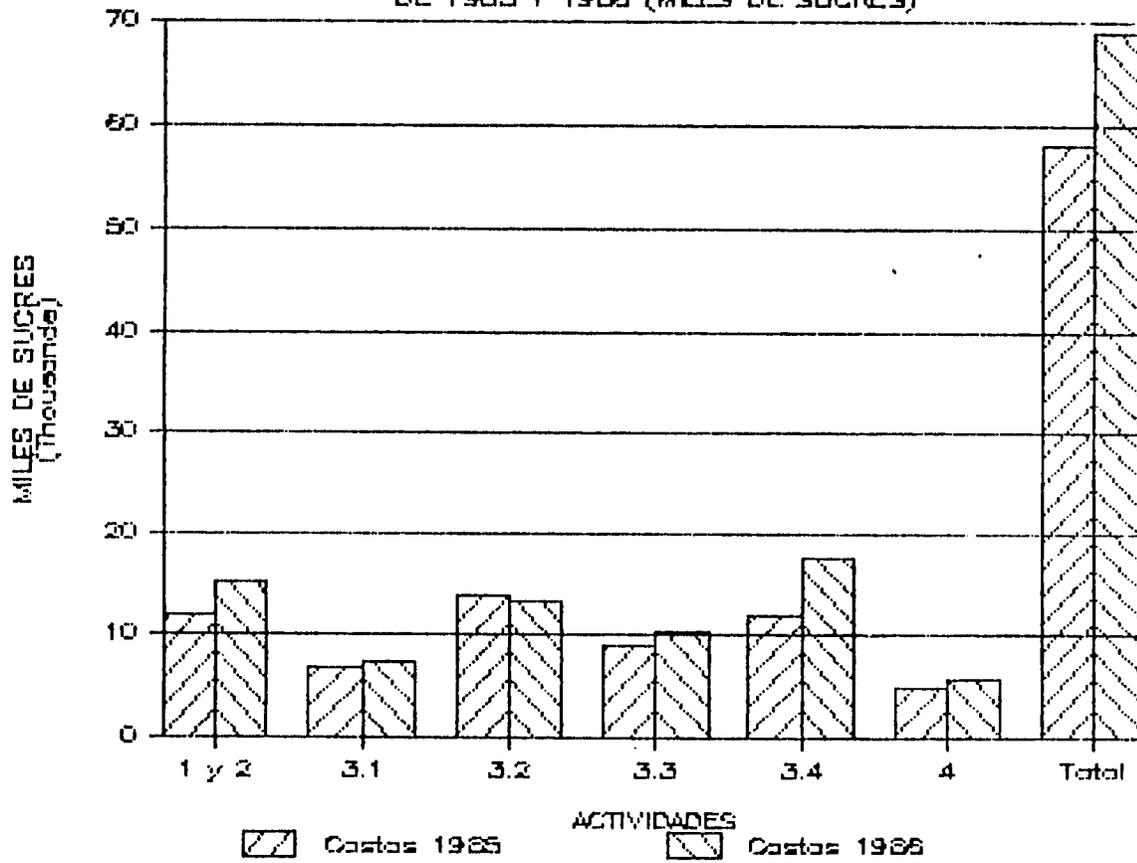
Chart 6. Cost of Production of Soya



1	PREPARACION DE SUELOS	S/.	6,000.00	S/.	7,500.00
2	SIEMBRA	S/.	5,900.00	S/.	7,600.00
3	FERTILIZANTES (FERTISA)	S/.	7,480.00	S/.	5,070.00
4	CONTROL DE MALEZAS	S/.	7,030.00	S/.	8,935.00
5	CONTROL DE INSECTOS	S/.	6,740.00	S/.	7,850.00
6	COSECHA	S/.	11,300.00	S/.	14,900.00
7	IMPUESTOS	S/.	4,000.50	S/.	4,666.95
Total	TOTAL GASTOS DIRECTOS	S/.	48,450.50	S/.	56,521.95

**Chart 7. Cost of Production of Hybrid Corn**

DE 1965 Y 1966 (MILES DE SUCRET)



1 y 2 Preparacion de Suelos y Siembra

3.1 Control de malesas

3.2 Fertilizacion

3.3 Control de insectos

3.4 Cosecha

4 Impuestos

Total TOTAL COSTOS DIRECTOS

Table 7. Ecuadorean Grain Production <sup>1/</sup>

Crop	1984	1985	1986	Change
	-- thousand metric tons --			percent
Rice (cascada):	459	468	463	-1
Corn	280	297	292	-2
Soya	57	77	58	-25
Sorghum	5	8	18	125

<sup>1/</sup> Fieldweights. Commercial net weights for 1986, excluding seed, are: milled rice, 222 tmt; corn and sorghum, 263 tmt; and soya, 52 tmt, based on ENAC projections.

Source: MOA.

Production of both corn and rice are projected to be slightly lower than year earlier, but sorghum production is projected to increase very sharply although its base is small.

Current stocks of corn and rice are large, primarily those owned by ENAC. Based on expectations of market prices near ENAC support levels for at least the first half of the year, the supply-use balance would be relatively tight for rice, but surplus for corn and sorghum unless relatively large export markets can be developed.

Table 8. Supply-Use Balance, 1986

Item	Rice (milled)	Corn and Sorghum
	-- thousand metric tons <sup>1/</sup> --	
Stocks	20.4	65.0
Production	222.1	263.1
Imports/Exports	15.0	-20.0
Supply	257.5	308.1
Consumption	242.7	243.6
Ending Stocks	14.8	64.5

<sup>1/</sup> Commercial weight basis, excluding seed.

Source: MOA.

Hard Corn and Sorghum

If the foregoing projections of supply and use are realized, pressure on corn prices will be heavy through most of the coming 12 months. ENAC will be forced to hold its current large stocks, and to buy additional grain to relieve pressure from the May and June harvest.

However, unless the harvest is significantly heavier than now expected, the production-consumption surplus for the year likely will not be extreme, even though stocks will increase sharply during May and June. Smaller production during the rest of the year, together with increasing consumption, would be expected to reduce stocks and could generate sufficient price strength to permit the domestic resale of part of ENAC stocks at favorable prices by March 1987 (Table 9).

This scenario would require ENAC to buy CDs for corn in April, May, and June, with relatively heavy purchasing in late May and early June, peak harvest periods. By that time, ENAC would control just under one-third of the nation's stocks. Prices would continue under pressure. As the June-July harvest ends, so should ENAC purchases, unless there is a demand for exports to Colombia.

As the season progresses, normal consumption would reduce private stocks after July. From more than 6 months' consumption in July, private stocks likely will drop to about 3 months' consumption by December-January, levels that could strengthen domestic prices. As private stocks drop still further, market prices likely will increase and ENAC could resell corn during March 1987.

**Table 9. Hard Corn and Sorghum: Production-Consumption Balance and ENAC Operations, 1986**

Month	Production	Consumption	Balance	ENAC Operations		
				Purchase	Cost	Stocks
	-- thousand metric tons --			1/	(mil S)	(tmt)
Beginning			65.0			45.0
April	29.7	20.0	74.7	2.0	50.49	47.0
May	60.2	20.1	114.8	7.5	189.32	54.5
June	80.9	20.1	175.6	5.0	126.21	59.5
July	31.4	20.2	186.8			59.5
August		20.2	166.6			59.5
September	11.0	20.3	157.3			59.5
October	18.5	20.3	155.5			59.5
November	23.6	20.4	158.7			59.5
December	7.7	20.4	146.0			59.5
January		20.5	125.5			59.5
February		20.5	105.0			59.5
March		20.6	84.4	-15.0	-492.23	44.5
Exports		20.0				
Total	263.0	263.6			-126.21	

1/ Purchases of CDs in the Bolsa at announced prices. Sales in the Bolsa at the ENAC minimum, 1.30 percent of the minimum.

Source: MOA.

### Rice

Based on current market expectations, the rice market will tighten throughout the last part of 1986. Market prices likely will weaken during the early harvest, especially in April and May, and ENAC purchases be required then to protect prices.

Unless the harvest exceeds current expectations, by late summer the prospect of consumption greater than production could begin to strengthen prices. As normal consumption continues, stocks will stabilize and decline, especially non-ENAC stocks.

Based on this expected pattern, ENAC should concentrate its purchases early in the year, largely during late May or June. By then, it will have isolated nearly 9 percent of annual consumption, likely an amount adequate to strengthen markets substantially. Furthermore, as stocks decline late in the year, it could be possible to sell ENAC CDs at favorable prices and thus more than recoup early season expenditures.

**Table 10. Milled Rice: Production-Consumption Balance and ENAC Operations, 1986**

Month	Production	Consumption	Balance	ENAC Operations			Stocks
				Purchase 1/	Milled	Rough	
-- thousand metric tons --						(mil S)	(tmt)
Beginning			20.4				10.4
April	15.9	20.0	16.3	3.0	4.8	149.00	13.4
May	9.7	20.1	35.9	7.5	12.0	372.49	20.9
June	56.9	20.1	72.7				20.9
July	19.9	20.2	72.4				20.9
August	9.9	20.2	62.1				20.9
September	31.4	20.2	73.3				20.9
October	35.0	20.3	88.0				20.9
November	8.9	20.3	76.6				20.9
December	4.5	20.3	60.8	-2.0	-3.2	-129.13	18.9
January		20.4	40.4	-7.5	-12.0	-484.24	11.4
February		20.4	20.0	-11.4	-18.2	-736.04	0
March		20.4	-0.4				
Imports	15.0						
<b>Total</b>	<b>237.1</b>	<b>242.9</b>		<b>-10.4</b>	<b>-16.6</b>	<b>-827.92</b>	

1/ Purchases of CDs in the Bolsa at announced prices. Sales in the Bolsa at the ENAC minimum, 1.30 percent of the minimum.

Source: MOA.

**APPENDIX A. PERSONS CONTACTED**Ministry of Agriculture

Ing. Guillermo Guerrero  
Subsecretario de Commercialization

Ricardo Davila  
Subsecretario, Coastal Region

Econ. Agr. Jorge Munoz  
Asesor, Ministerio de Agricultura y Ganaderia

Alfonso Serrano, ENAC

Gonzalo Llanguri, ENAC

Rodigo Crespo Fabara, Special Advisor to the Minister

USAID

John O'Donnell, Agriculture

Dale Colyer, Agriculture

Tomas Doudebes, Agriculture

U.S. Embassy

Cleveland Marsh, Agricultural Attache

Bolsa Nacional de Productos

Juan Zevallos Chevasco, Executive Director

Juan Trujillo, Director

Econ. Alberto Villegas, Director

Almacopio

Daniel Canizares, Director

Others

Jose Chiriboga, AFABA

Jose Llanez, President, FENACOM

Carlos Vitelli, Econ., FENACOM

David Franklin, Sigma One Corporation

Bruce Schulte, Sigma One Corporation

Quentin West, Sigma One Corporation

## APPENDIX B. LONG-TERM FUNDING FOR THE BOLSA

Guayaquil, 6 de febrero de 1986

*Qui*  
12 FEB 86  
11:30 a.m.

Economista  
JORGE NUÑOZ  
Ministerio de Agricultura  
y Ganadería  
Piso 10mo.  
Quito

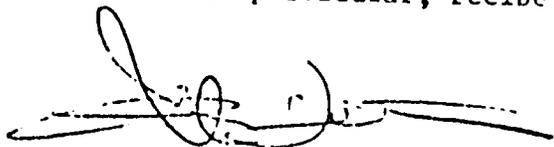
Apreciado Jorge:

Te acompaño el Cuadro de Cosecha estimada para el año de 1986, a los precios de sustentación vigente, sobre el que nos hemos basado para estimar el volumen de producción - que aspira a captar la Bolsa de Productos durante los años 1986, 1987 y 1988.

Además te adjunto también el detalle de cifras totales de los Ingresos y Egresos para los mismos años.

Como notarás, a 1988 habremos terminado con un déficit acumulado de (S/.23'589.000) sucres.

Sin otro particular, recibe un fuerte abrazo,



Eco. Juan Zevallos Chevasco

:1b

CORPORACION BOLSA NACIONAL DE PRODUCTOS ACROPECUARIOS

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INGRESOS Y EGRESOS DE CAJA PARA LOS AÑOS 1986, 1987 1988

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	ANEXOS	1986	1987	1988
		(Cifras en miles)		
INGRESOS POR COMISIONES	2	31.838	35.273	50.123
EGRESOS:				
Sueldos y Beneficios sociales		26.544	29.200	32.120
Otros desembolsos operativos		<u>19.166</u>	<u>16.105</u>	<u>17.688</u>
TOTAL		<u>45.710</u>	<u>45.305</u>	<u>49.808</u>
EXCEDENTE (DEFICIT)		( 13.872) =====	( 10.032) =====	315 =====
DEFICIT ACUMULADO		( 13,872) =====	( 23.904; =====	(23.589) =====

Guayaquil, 6 de febrero de 1986

CORPORACION BOLSA NACIONAL DE PRODUCTOS AGROPECUARIOS

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COSECHA ESTIMADA PARA 1986 VALUADA A PRECIOS DE SUSTENTACION VIGENTES

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Producto	Cosecha	T.M. estimado	T.M. a quintal	Precio quintal	Sucres en millones
Arróz cáscara	INVIERNO	210.000	7.700.000	1.200	9.240
	VERANO	140.000			
		<u>350.000</u>			
Arróz pilado		350.000 (cáscara)	5.005.000	2.400	12.012
Maíz Duro	INVIERNO	136.000	3.000.000	1.000	4.200
	VERANO	54.500	1.200.000		
		<u>190.500</u>	<u>4.200.000</u>		
Soya	INVIERNO	8.223	1.067.500	1.680	1.793
	VERANO	40.600			
		<u>48.523</u>			

CORPORACION BOLSA NACIONAL DE PRODUCTOS AGROPECUARIOS

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INGRESOS POR COMISIONES PARA LOS AÑOS 1986, 1987 y 1988

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Producto	% de Participación	<u>1986</u>	% de Participación	<u>1987</u>	% de Participación	<u>1988</u>
Arróz cáscara	6	554.000	8	739.000	10	924.000
Arróz pilado	12	1.441.000	13	1.561.000	20	2.402.000
Maíz duro	12	504.000	13	546.000	20	840.000
Soya	40	<u>717.000</u>	40	<u>717.000</u>	50	<u>897.000</u>
Total		3.216.000		3.563.000		5.063.000
Compra-Venta (x2)		<u>6.432.000</u>		<u>7.126.000</u>		<u>10.126.000</u>
Comisión Corredores 1.5%		<u>96.480</u>		<u>106.890</u>		<u>151.890</u>
Comisión de Bolsa 0.33%		<u>31.838</u>		<u>35.273</u>		<u>50.123</u>

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Guayaquil, 6 de febrero de 1986