ABSTRACT

Report on Privatization Component for USAID Trade and Investment Project in Ecuador

by

Richard Mallon and Ravi Ramamurti

June 1991

USAID/Ecuador undertook this study to help develop a strategy and specific interventions for supporting privatization as one component of its proposed Trade and Investment project. The report finds that economic policy in Ecuador does not encourage competitive behavior and concludes that both the public and private sectors need to be privatized. It reviews recent progress toward opening up the economy; examines the status of the state-owned enterprises (SOEs), considers the possibilities for the divestiture of selected SOEs; assesses the potential for the demonopolization of others; considers candidates for liquidation. The report concludes with recommendations for possible areas for A.I.D. assistance, including restructuring and improving the efficiency of SOEs; divestiture, demonopolization, and liquidation.
REPORT ON PRIVATIZATION COMPONENT FOR USAID
TRADE AND INVESTMENT PROJECT IN ECUADOR

I. Introduction

Richard Mallon and Ravi Ramamurti visited Ecuador at the invitation of the local USAID Mission during May 5-22, 1991 to assist in developing a strategy and specific interventions for supporting privatization as one component of the Mission's proposed Trade and Investment project. Their visit was financed through a buy-in under the CAER project between USAID/Washington and the Harvard Institute for International Development.

A list of interviews carried out and the main documents consulted by Mallon and Ramamurti is attached. They would like to express their appreciation to staff members of the local USAID Mission, especially Mr. Kent Eaton, Mr. Milton Nuñez, and Mr. Wayne Camard, for their help, which together with the generous cooperation of Ecuadorian officials and businessmen made it possible to complete their mission on time.

II. Scope of Privatization

The term "privatization" needs to be defined in the broadest terms. Private enterprise performs efficiently and effectively when it unleashes entrepreneurial skills and faces fierce competition. Simply transferring enterprise ownership from government to the private sector does not necessarily achieve these benefits if competition is weak.

Economic policy in Ecuador does not encourage competitive behavior. The environment has been described in the following terms:

tax concessions and exemptions, restrictive labor laws, public sector job creation, credit allocations, interest rate subsidies, and extensive public ownership of commercial enterprises."

Pervasive interference with market forces has created an interdependent government/private enterprise complex that restricts competition in both the public and private sectors and between them. Partly in response to the contra-competitive policies mentioned in the previous paragraph, many private businesses have found it beneficial to organize themselves in closely held conglomerates owned and controlled by a few "grupos." This form of organization maximizes the political clout businessmen can use to extract privileges from government, restrict competition, and take advantage of insider lending from "grupo"-owned banks. Labor unions follow a similar organizational strategy to promote their own group interests.

Both the public and private sectors thus need to be "privatized" in Ecuador. Demonopolization to open up the economy to wider competition in markets for goods and services, factors, and financial services is essential to derive positive benefits from the divestiture of state-owned enterprises (SOEs). Equally important in a market economy is freedom of exit, that is, the obligation of failed firms in both the public and private sectors to declare bankruptcy and risk liquidation instead of relying on government bailouts.

III. Recent Progress Toward Opening Up the Economy

The movement toward Andean Pact integration, culminating in the May, 1991 meeting of member country presidents in Caracas, has obliged Ecuador to choose between increasing isolation or greater economic liberalization. The only concession that Ecuador was able to obtain in the meeting was a six month delay in eliminating trade barriers with other member countries. Since most of these countries have already advanced much further in liberalizing their economies, Ecuador has no choice but to follow suit to avoid suffering from a serious competitive disadvantage.

In preparation for the meeting of presidents, the Ecuadorian government set up eight Study Commissions with representatives from both the public and private sectors and coordinated by the "Oficina

Técnica de la Presidencia." The subjects studied were labor policy, trade promotion, industrial development policy, agricultural policy, tariff policy and methods of integration, efficiency and simplification of the public sector, financial policy and investment promotion, and policies for transportation, communications, and other services. The reports of these commissions are still confidential, but the consultants were able to learn about some of their recommendations by interviewing participants and observing recent government decisions.

For example, a new labor law drafted by representatives of labor, management, and government in May 1991 was expected to raise the minimum number of employees necessary for unionization from 15 to perhaps 30 or 35, reduce the compensation payable to laid off workers, question the legality of "sympathy strikes," and introduce a compulsory cooling off period before workers could strike. Yet, some formidable barriers to labor mobility would remain: for instance, the government would still have to approve firings.

With regard to stock market reform, the current situation is that secondary transactions in privately owned stocks account for less than one percent of all transactions in the exchanges at Quito and Guayaquil, with most of the rest being accounted for by government bills sold by public sector organizations. Most transactions in private paper are believed to occur in the over-the-counter (OTC) market which is not noted for its transparency, thus making it possible for intermediaries to earn excess profits at the cost of small investors who do not possess insider information. Recent government decisions have been aimed at correcting this situation and establishing a more openly competitive capital market.

The capital gains tax has been eliminated, the highest marginal tax rate has been reduced from over 70 percent to only 25 percent, and real interest rates for borrowers have been increased. Ecuadoran companies are therefore likely to find that equity rather than debt financing is becoming more attractive. A new stock market reform bill, drafted with inputs from the World Bank and the U.S. Securities Exchange Commission, proposes turning the stock exchanges into nonprofit organizations managed by stockbrokers themselves and supervised by an independent regulatory agency. This bill does not seem likely to be approved as proposed, but there is still hope that the reform that is finally approved will make the exchanges more responsive to the needs of investors.

The National Administrative Development Secretariat (SENDA) has been charged with evaluating SOEs and examining ways to encourage private sector participation through the creation of joint ventures and other means. The UNDP is providing technical assistance to help SENDA carry out this task. In the recent executive decree ordering a 15% across-the-board cut in government expenditures, a rider was attached requiring SENDA to submit its
These and other recent developments indicate that reforms to open up the Ecuadorian economy and expand private sector participation are gaining momentum during the final year of the present administration and could well carry over into the next government. The time seems ripe to develop a USAID strategy and specific interventions to support privatization as a component of the Mission's proposed Trade and Investment project.

IV. State-Owned Enterprises

A. Relative importance of the SOE sector: Gross spending of public enterprises (excluding transfers and petroleum) increased from about 4% of GDP at the beginning of the 1970s to 14% in the early 1980s. New petroleum wealth was used to establish many SOEs during this period: ENFE in 1970, TRANSNAVE in 1971, IETEL in 1972, DINE and FLOPEC in 1973, ECUATORIANA and ENAC in 1974, etc.

Data are not available on the share of SOE value added in GDP, but it appears that Ecuador still ranks well below the world average for mixed economies of 10 to 15% (again excluding the petroleum sector). Fully owned public enterprises are limited mainly to infrastructure services, whereas government participation in manufacturing, finance, and other services is (unlike many other developing countries) mainly in mixed enterprises in which private owners hold substantial equity.

B. Major problems of the SOE sector: The SOE sector has not accounted for a large part of the non-financial public sector deficit in Ecuador. When the NFPS deficit amounted to between 2 and 10% of GDP in 1986-89, SOEs contributed less than 15%, almost all of which was accounted for by a single enterprise, INECEL. This does not by any means signify that the finances of other public enterprises are satisfactory; many of them do not generate sufficient funds to finance an adequate level of investment or to service fully their debt (but of course Ecuador's foreign debt is not now being fully serviced). The financial problems of SOEs are therefore likely to become increasingly serious in the future unless significant reforms are carried out.

At present the most serious problem of the public enterprise sector is that it is a major impediment to increasing the

3. See Statistical Appendix Tables 12 and following in World Bank, Op. cit. SOE deficits are calculated as the difference between net operating income and capital expenditures. Transfers between government and SOEs and debt service are not included because of the lack of transparency in these transactions (e.g. public accounts do not make it clear who is subsidizing whom).
efficiency and international competitiveness of the Ecuadorian economy, precisely because it controls key infrastructure services. Without more efficient transportation, telecommunications, and energy, the country will not be able to take full advantage of the opportunities provided by Andean Market integration and the gradual opening of the economy to the world market. The main impediments are:

1. Fully owned SOEs operate under virtually the same regulations and controls as the central government bureaucracy. These enterprises have neither the autonomy nor the flexibility with respect to procurement, personnel, contracting, pricing, and other matters that managers require to be held accountable for results; and the accounting rules imposed by the "Contraloria" are completely unsuitable for controlling SOE operations as cost or profit centers as business firms should be. Ecuador appears to be almost a decade behind in reforming the relationship between governments and SOEs in the more advanced developing countries. As a first step toward necessary reforms, public enterprises should be converted into "sociedades anónimas" and placed under the supervision of the "Superintendencia de Compañías."

2. Before being given greater managerial autonomy, however, SOEs would have to be subjected to "hard" budget constraints to make them financially self-supporting without disguised subsidies; their relations with government would have to be regulated by some form of "performance contract" that specifies reciprocal commitments, sets measurable performance targets, and provides incentives and sanctions based on results; and outside interference by government officials, politicians, or boards of directors in day-to-day operations would have to be severely curtailed.

3. Many SOEs are given artificial monopoly rights that restrict competition (see section V below). Such rights should be eliminated and public enterprises exposed to as much competition as possible.

4. Some public service SOEs (or parts of them) are natural monopolies. Tariffs and service levels of these enterprises are currently regulated by their boards of directors or by the political process with disastrous results. INECEL, for instance, is managed by a board consisting of the ministers of economy, industry, planning, the presidency, workers, local power companies, private sector users, and a professor. Tariffs are set by the board unless Congress has involved itself in the process, as for example when it recently limited tariff increases to 3 percent per month, well below the rate of inflation. Average tariffs measured in US-dollars fell for both bulk and small users between 1980 and 1987 and are presently well below long run marginal costs. Retail prices tend to be uniform regardless of cost of delivery and time of day.
In the case of airlines, the agency responsible for regulation is the Dept. of Civil Aviation (DAC), which is controlled by the Air Force (which also owns the domestic airline, TAME). DAC is also responsible for running the airports and for setting landing fees. Besides the obvious conflicts of interest built into the regulatory arrangement, DAC is believed to lack technical and economic expertise to do its job well.

Independent, professional agencies should be set up to carry out these regulatory functions, especially for determining reasonable criteria for tariff rates and explicit subsidies. Creation of professional regulatory agencies would not of course eliminate political decisions, but they could help make the costs of low tariffs and subsidies more transparent.

5. A number of public service SOEs do not have sufficient access to the capital, technology, and/or management skills they need to provide efficient services. These enterprises are prime candidates for full or partial divestiture and/or contracting out operations.

V. Divestiture

A. Fully owned SOEs: A special law would be required to divest these enterprises unless they are first converted into "sociedades anónimas." Once this is done, selling shares to the private sector would not appear to pose insuperable legal obstacles. Before shares of enterprises were sold, however, it would be highly desirable if not indispensable to eliminate any artificial monopoly rights they may have, and if they have natural monopoly powers, to set up an appropriate government regulatory system. No fully owned SOE appears ready yet for complete divestiture, but several can be considered as candidates for partial divestiture or the spinning off of some of their activities.

1. ECUATORIANA: This enterprise is perhaps farthest along on the route to privatization. The plan is to sell it by early 1992, before the current government's term ends in August 1992. The national executive including the military have decided to request the legislature to permit conversion of ECUATORIANA into a mixed enterprise. The idea at present is to divide ownership into about one-third government (probably the military), one-third private domestic (including 5% for employees), and one-third foreign (the CEO favors making Japan or Korean Airlines the foreign partner). The present CEO is a private businessman who has been on the job for only two months and wants to make the airline a commercial success by selling shares on credit to travel agents, establishing a frequent flyer program, attracting more tourists (especially Japanese), giving generous baggage allowances to passengers, etc. His motivation for forming a mixed enterprise is not to obtain capital (he claims that fuel and repair savings alone
are sufficient to finance the lease-purchase of two new air buses) but to escape the stifling regulations of the "Contraloría" and to establish connecting routes with a major international carrier.

There is no doubt, however, that cutting operating costs and modernizing the fleet will be necessary to improve ECuatoriana's financial performance and capacity utilization, especially in view of the fact that the antiquated aircraft now being used suffer exorbitant downtime for repairs and will not be able to satisfy noise pollution standards that will come into force shortly in the U.S. The main issues that have to be resolved to pave the way for divestiture are: 1) Determination of the enterprise's net worth (valuation of tangible and intangible assets and a company audit); 2. revision of labor union contracts and work rules; 3) decision on who will exercise effective control of management (the foreign partner is likely to insist on control, but domestic control may be necessary for political reasons and to maintain ECuatoriana's status as a national flag carrier); and 4) clarification of regulatory policies now exercised by the DAC. Very little thought seems to have been given to eliminating Equatoriana's artificial monopoly rights or to the regulatory regime after privatization. For instance, it is not clear if SAETA, the private airline that also operates on the Quito-Miami route, will be permitted in the future to also operate some flights on the lucrative Quito-New York route. (At present, Equatoriana is the only Ecuadoran carrier operating on that route.)

2. INECEL: The electric generation and transmission enterprise is fully owned by the central government, but the 18 local distribution companies are organized as "sociedades anónimas," about one-third of whose shares are owned by municipal councils and others (the other two-thirds are held by INECEL). The general manager has recently been quoted in the press as favoring privatization of local distribution companies, but there are at least three major obstacles: 1) Tariffs are politically determined with little concern for the financial viability of the enterprises -- small consumers are heavily subsidized with the result that INECEL is the main source of SOE deficits in Ecuador; 2) in the absence of any serious regulatory authority for this natural monopoly, there is little chance for rationalizing tariff policy or avoiding the abuses that EMELEC (the privately owned electric power company in Guayaquil) is accused of; and 3) divestiture is unlikely to enhance efficiency if the new owners lack the capital, know-how, and effective managerial control necessary to improve performance (e.g. the new ownership proposed for EMELEC and many electric power cooperatives in other countries).

Any serious privatization in the electricity sector would therefore have to be preceded by efforts to clarify the rules of the game (e.g. government regulation of tariff policy, permitted rates of return on new investment and its financing, the level and quality of service, etc.). Otherwise, companies with the capital
and know-how to improve performance will not be interested. In the meantime, the most practical way to increase private participation in the sector would probably be to encourage contracting out maintenance, meter reading, and other ancillary services of the electric power companies.

3. Port of Manta: Port authorities have reportedly expressed an interest in privatizing operations. In view of the fact that a "zona maquilladora" is located in Manta, divestiture of all or part of port facilities or contracting out their operation to private management could be especially attractive to private business groups and to government as a pilot experiment.

4. "Agua Potable de Quito": Recent expansion was accomplished with a reduction in personnel because all possible construction and maintenance services have been contracted out. Management is trying to introduce internal financial and accounting reforms to facilitate operation of the enterprise along business lines, but these reforms are impeded by "Contraloría" restrictions. "Agua Potable de Quito" could serve as a model for other SOEs, not only other municipal water companies but enterprises such as ENFE, which could spin off activities to private contractors or leasees to reduce over-staffing and become more financially viable.

5. ENFE: The decline in railway passenger and cargo traffic by 75 and 82 percent respectively between 1980 and 1988 has made the enterprise unviable. Track and rolling stock need rehabilitation, but before rehabilitation the enterprise should be completely restructured by closing lines that are no longer competitive with road transport, contracting or leasing out operation of maintenance facilities, terminals and selective cargo movements, and reducing excess personnel. The performance contract recently signed with Bolivian ENFE could serve as a model. This contract calls for a 30% reduction in the railway work force in the first year and the sale of surplus property to the private sector to finance the corresponding worker indemnization payments.

B. Mixed SOEs: Government owned shares in these enterprises are mostly held by CFN, BNF, DINE, and IESS. They were acquired either for promotional purposes or to bail out failed private firms, or in the case of IESS to provide investment income. Eventual divestiture is a logical sequence for promotional enterprises; bail-outs should be divested after restructuring or liquidated (see below). The current situation with respect to these mixed SOEs is as follows:

1. CFN: During the period 1981-89 CFN sold its entire holdings in eight mixed enterprises and part of its holdings in another three. After Dr. Moscoso became chief executive, CFN sold the balance of its holdings in the latter three firms and its entire holdings in six additional enterprises. Although the number of firms divested may seem important, a mere S/.1.04 billion (US$
1 million approximately) have been raised through these sales. As of May 1991, CFN held shares in 22 other companies with a total nominal value of S/.31.4 billion (about US$ 30 million). Three firms -- La Cementa Nacional, AZTRA (sugar), and Selva Alegre (cement) -- accounted for 80% of CFN's holdings. CFN's board has decided to divest all these holdings by the end of 1991 (see list attached).

All CFN holdings have been divested through the "Bolsas" (on which the Corporation holds a seat) at prices approved by the board based on book value and projected cash flows (using techniques learned from Price Waterhouse). No shares were sold on credit. According to the chief executive, some shares were disposed off in barely a few hours; others took 4-5 weeks to sell. No restrictions were placed on the nationality of the buyers or the amount of shares acquired by any single investor. The most marketable items in CFN's portfolio are the cement companies and the 15% holdings in Hotel Colon. Least marketable are firms like AZTRA and Chapas y Maderas (plywood).

2. BNF: A "Reglamento Para la Venta de Acciones de Propiedad" was adopted in February, 1990 and has been approved by the "Superintendencia de Bancos," and a list of 11 enterprises (out of a total of 15 in which the BNF owns shares) has been approved for sale (see attached). The BNF is obliged to give preference in the sale of shares to suppliers of raw materials and employees. If they are not interested, then the shares will be sold through the "Bolsas" as the CFN is doing. The President and General Manager claim that in future the BNF will only extend credit to borrowers, not buy shares in their enterprises. The Flota Mercante Grancolombia, in which the Banco holds 20% of the equity, represents the largest bundle of shares in the list. Management believes that an international shipping company should be interested in purchasing BNF's holdings in view of the new opportunities that will be provided by Andean Group integration. But some other enterprises will be difficult to sell: for example, the only investors that have so far expressed an interest in buying FERTIZA are creditor banks, and CEMENTO CHIMBORAZO needs to spend an estimated $13 million on the modernization of plant and equipment.

3. DINE: Fully owns two enterprises (FAME and Fábrica de Municiones) and holds shares in about 17 mixed SOEs; the number is may not be exact because DINE, unlike the CFN and BNF, is continually adding new firms to its portfolio. The policy of DINE is that private entrepreneurs/investors and the military make a perfect match in setting up and running new strategic enterprises, and that divestiture of DINE's holdings will only make sense when "national culture matures and democratic stability is assured." Two of DINE's joint ventures -- Iskra Emec (recently acquired from the CFN) and Agrincem Galápagos -- are export oriented. Plans for investing in new enterprises include production of generic
medicines, fertilizers, cement (possibly for export to Brazil), paper pulp using native raw materials, gold and other minerals (in which foreign partners would be welcome), agro-industry, and tourism (a five-star hotel and an ecological tourism operation in the Amazonas). To the extent that Ecuador opens up its economy to international competition, DINE will have to revise its import substitution industrialization strategy.

4. IESS: Only about 10% of investments are in enterprise shares, which would represent a very prudent investment of social security contributions if the portfolio were well selected and managed. The "Centro de Estudios y Análisis" claims that IESS investments in enterprises such as Banco del Pacífico, Cervecería Andina, Club de Ejecutivos, and Hotel Colón are very remunerative, whereas the World Bank maintains that IESS equity investments yielded a negative real rate of return between 1984 and 1987. But the problem in the case of IESS is not divestiture per se but proper management of its investment portfolio, in which demonopolization of social insurance could play a useful role.

VI. Demonopolization

A. Public sector: A number of SOEs enjoy artificial monopoly rights that often cannot be fully enforced (e.g. the municipal ordinance that requires that all local milk production be processed by PROLACOM). But these artificial restraints still constitute serious impediments to improving the efficiency and international competitiveness of the Ecuadorian economy and should be eliminated, especially in the following areas:

1. Transportation: TRANSNAVE is guaranteed the right to transport 50% of all sea cargo to and from Ecuador by the "protección de carga" law of 1973. FLOPEC has been granted a monopoly on transporting oil to and from Ecuador that it uses to extract fees from private carriers for waiving its monopoly privileges. ECUATORIANA is protected from competition from other international carriers in the provision of combined cargo-passenger services.

2. Telecommunications: The monopoly of IETEL is partly natural and partly artificial -- local residential phone service and operation of the national trunk line grid and satellite transmission tend to be natural monopolies, whereas individual long-distance and special services (e.g. electronic data transmission, cellular phones, etc.) can be provided competitively, especially if the national trunk line is converted into a common carrier. IETEL has permitted some competition (e.g. Banco del Pacífico has been permitted to install its own direct satellite transmission facilities), but permissions are tedious to negotiate. Such permissions should be made generally available, but only after current tariff policy that imposes exhorbitant charges on long
distance communications to cross-subsidize local calls is revised and the national communications grid is converted into a common carrier. Otherwise, a false incentive will be given to install private long-distance facilities that distort the allocation of the country's scarce resources and will turn out to be unprofitable once tariffs are rationalized.

3. Pension funds: The IESS presently enjoys an artificial monopoly in the administration of pension funds and other social insurance programs. This monopoly has led to massive inefficiency, as pointed out by the World Bank and other observers. Private social insurance funds, perhaps modeled along the lines of the system in Chile, should be allowed to compete. A first step in this direction could be the introduction of private schemes for workers' reserve funds. Creation of private social insurance funds could greatly assist the diversification and deepening of domestic capital markets and the creation of new instruments such as mutual funds. The redirection of social insurance funds away from "privativas" (low-yielding personal and mortgage loans in which the IESS invests most of its money) toward productive investments would also help finance the government's privatization efforts and spur economic growth.

B. Private sector: Widespread monopolization or cartelization of private markets in Ecuador constitutes a formidable obstacle to privatization. Popular support for privatization is eroded by the perception that private monopolists exploit consumers, and professional analysts doubt that simply converting government monopolies into private ones is likely to improve enterprise efficiency. Demonopolization or "privatization" of the private sector could therefore contribute immensely to gaining support for and assuring positive results from privatization, especially in the following areas:

1. Anti-monopoly legislation could be considered to discourage vertical integration (e.g. Naboa and Wong in bananas, fruit packing boxes, and shipping) and horizontal integration (e.g. "grupo" domination of the press and television). Admittedly this is an area in which enforcement is extremely difficult, but at least membership in associations should not be required to participate in any economic activities. And where licensing is required to regulate public services such as transportation and communications, more concern could be shown for the dispersion of ownership and control.

2. "Grupo" domination of important sectors of the economy is facilitated by the organization of most Ecuadorian businesses in the form of closely-held family firms. The reluctance of businesses to "go public" and sell shares in the open market is

---

partly a matter of tradition but also represents a rational response to existing incentives. The most important disincentives for "going public" are probably financial (see below), but the virtual absence of any obligation on the part of privately held firms to disclose information is an added disincentive. On the other hand, more comprehensive disclosure rules for such firms would be extremely difficult to enforce.

3. Negative real interest rates currently prevailing in financial markets are probably the most important disincentive for family firms to "go public." It is obviously more attractive to rely on subsidized loans than on outside equity investments to finance enterprise needs, especially when the latter could also threaten family control. Interest rates have been increasing in real terms during recent months, but they are still not high enough to induce most firms to seek alternative sources of financing.

4. So long as real interest rates remain relatively low, "grupos" that own enterprises have a strong incentive to also own and control banks and other financial institutions. Preferential access to borrowed funds through "insider lending" is quite common within "grupo" conglomerates in Ecuador. This source of financing is not only cheaper but also allows debtor firms to transfer business risks away from equity holders to bank depositors (or to government if it guarantees bank deposits either de jure or de facto). One step that could be taken to ameliorate this situation and strengthen financial markets would be to empower the "Superintendencia de Bancos" to restrict insider lending.

5. A complementary step in this direction would be to strengthen the capacity of the "Superintendencia de Compañías" to assure full disclosure of the financial status of companies that wish to float paper on the stock exchanges. Currently any nonfinancial company, whether public or private, which has 5 or more shareholders and S/.2 million in sales is required to file annually its balance sheet, income statement, imports, exports, and number of employees with the Superintendencia de Compañías. Compliance is poor, however, because the penalties for filing late are very small. Only companies whose stock is traded on the Bolsas are required to publicly disclose their balance sheets, but not their income statements or notes to the accounts. It is thus very difficult to make sense of the published information.

VII. Liquidation

A. Freedom of exit through liquidation is just as important as

---

freedom of entry to assure adequate competition. If firms are not allowed to go broke, entrepreneurs will have little incentive to compare the risks and returns of alternative investments. And so long as government stands ready to bail out failed firms, the dividing line between private and state-owned enterprises will remain blurred.

B. Among state-owned firms there are undoubtedly a number of candidates for liquidation. Chapas y Maderas de Esmeraldas mentioned earlier appears to be one of them; it will most likely remain on the books of the CFN forever unless it is closed down. Similarly, ENPROVIT is economically unviable and seems to have forgotten its social mission of supplying essential goods to the poor. ENAC also has serious problems, but perhaps a case can be made for retaining it rice operations to assist small farmers and spinning off its procurement of beans. Mexico's experiment with privatizing CONASUPO may be relevant here.

Liquidation is of course a very politically sensitive policy, mainly because of the impact it has on employment in the absence of government retraining and job placement programs. In the case of liquidating failed financial institutions there is the additional problem of protecting depositors, which can turn into a financial "black hole" if bank regulation is lax. Despite the difficulties, however, this remains an area where reform is necessary.

VIII. Possible Areas for AID Assistance

A. Restructuring and improving the efficiency of SOEs: This is an area in which the World Bank and the UNDP are very active. It would thus appear that this area should not receive AID's priority attention, but the UNDP (Luis Alfredo Maldonado) expressed an interest in AID collaboration with their project when they reach the stage of spinning off public enterprise activities. In the meantime AID might wish to consider the following:

1. Assist government to carry out a comprehensive managerial, financial, and technical audit of a major SOE, perhaps ICETEL, to identify opportunities for spinning off or contracting out activities to the private sector, for allowing competition where natural monopoly conditions are absent, for restructuring management and MIS along business lines, and for rationalizing tariffs and personnel.

2. Offer technical assistance to ENFE on how to become more competitive by spinning off losing services, contracting out activities to the private sector, and disposing of idle properties. The studies carried out in formulating a performance contract with Bolivian ENFE could serve as a guide.

3. Offer to help DINE set up a joint venture ecological
tourism project in collaboration with Smithsonian (this initiative could help mend fences with the Ecuadorian military).

B. Divestiture: There is considerable scope for AID assistance in the area of conceptualizing and sharing divestiture experiences, and selectively in the process itself:

1. Include more sessions on the subject of divestiture in the policy dialogues led by INCAE.

2. Sponsor a study on the use of debt-equity swaps for financing foreign acquisitions. It is apparently poorly understood in Ecuador, for example, that swaps involving the transfer of ownership of existing assets are not inflationary.

3. Organize a seminar on the selection of joint venture partners. This is likely to be one of the main forms of divestiture used in Ecuador, and serious people like Edison Ortiz (member of the Commission on divestiture of ECUATORIANA) are asking relevant questions about the compatibility of foreign and local partners (e.g. experience of SAS in Chile), the feasibility of extracting advance commitments from foreign partners on improvements to be made (e.g. Mexican vs. Argentine experience with telecommunications), the valuation of intangible assets such as airline routes and landing rights, etc.

4. Assist Ecuatoriana to carry out a financial audit, to assess the value of its tangible and intangible assets, and to prepare a prospectus for partial divestiture.

5. Organize a seminar on contracting out SOE management and other services to the private sector, using Agua Potable de Quito and international case studies and inviting active participation of Manta Port authorities.

6. Since BNF has no previous experience with divestiture, the President and General Manager would welcome technical assistance in preparing sales prospectuses and evaluating offers from buyers, similar to the assistance provided by Robert Laport to the CFN several years ago. The BNF would also welcome assistance in identifying a foreign buyer for its shares in the Flota Mercantil Grancolombia; this assistance could be linked to relaxing "reserva de carga" restrictions on maritime transport.

7. Offer technical assistance for setting up independent, professional bodies for regulating levels and tariffs of public services, especially for electricity and telecommunications. The U.S. has more experience than any other country in government regulation of the private provision of public services, and strengthening regulatory systems to clarify rules of the game is an indispensable first step toward eventual privatization of these services.
C. Demonopolization: This is an innovative area that deserves high priority attention from AID, especially because it offers an opportunity to broaden private sector participation in activities currently dominated or restricted by government:

1. Organize a seminar on the competitive provision of long distance and special telecommunications services, the real cost reductions that can be achieved by adopting advanced communications technology, the relation between efficient communications and international competitiveness of the economy, and benefits that can be obtained by converting the national IETEL network into a common carrier. International travel could also be financed for seminar participants to learn how this is being done in the U.S., Chile, and other countries.

2. Provide technical assistance to a consortium of private financial firms (Ramiro Crespo of INVESTBAN would be a good counterpart) on the development of new instruments such as mutual funds that could be transacted in the stock exchanges for mobilizing private savings for risk capital investment. Such instruments would help bring smaller savers into a market now dominated by large investors in short-term securities and by government financial institutions in longer term lending.

3. Sponsor a study of the development of private pension and social insurance funds to provide competition for the IESS. The Federación de Industrias (contact Gustavo Pinto) and the Fundación Adam Smith (see letter to Mr. Costello of May 8, 1991) would be delighted to collaborate, but an effort should also be made to include some of the more enlightened labor unions to convince them that they would be the main beneficiaries. Creation of private pension funds would also help increase funds available for investment in the savings instruments mentioned in para. 2 above.

4. Offer technical assistance in drafting anti-monopoly legislation (covering both state-owned and private enterprises) and setting up an implementing body.

5. Provide technical assistance to the Superintendencia de Compañías to strengthen its surveillance of the Bolsas to assure full disclosure of information about firms and funds quoted in the exchanges and the content and accuracy of information contained in prospectuses for new issues of securities on the exchanges. Strengthening of stock market supervision is essential to inspire confidence of new investors and to broaden Bolsa operations.

6. Provide technical assistance to the Superintendencia de Bancos to strengthen surveillance of insider lending and the soundness of financial institution portfolios. Strengthening regulation of financial institutions is indispensable for creating
confidence on the part of savers and investors who do not belong to the "grupos" and for broadening and deepening capital markets.

7. Demonopolization of Conuep's of higher education should receive AID's highest priority, because without an adequate supply of well trained managers and techniciars Ecuador cannot possibly compete in the international market. But it is not at all clear how AID can help resolve such an explosive political bottleneck, especially in view of the unsatisfactory result of the Houston University contract (source: Marcelo Laniado of the Banco del Pacífico). Perhaps as a first step the new INCAE MBA program could be supplemented by in-service training provided by major Ecuadorian companies.

D. Liquidation: The main barrier to liquidation of non-viable enterprises in which government holds equity is the threat of unemployment. To help solve this problem AID could sponsor an experimental retraining and rehabilitation program to assist unemployed workers to find alternative employment. If IMPROVIT were liquidated, for example, AID could conceivably provide modest financing to help displaced employees set up private retail establishments.
LISTA DE EMPRESAS QUE CONSTAN EN EL PLAN DE DESINVERSION

- LECOCEM
- PROLACEM
- COMPROLACSA
- ALMACAO
- BANCO DE GUAYAQUIL
- MERCADO MAYORISTA
- DACA
- ALGRACESA
- ALMACOPIO
- FERTISA
- FLOTA MERCANTE GRANCOLOMBIANA
### VENTA DE ACCIONES

**MILES DE SUCRES**

<table>
<thead>
<tr>
<th>VALOR NOMINAL</th>
<th>VALOR DE VENTA</th>
<th>UTILIDAD (PERDIDA)</th>
<th>FECHA VENTA</th>
</tr>
</thead>
<tbody>
<tr>
<td>262</td>
<td>262</td>
<td>-</td>
<td>VIII-81</td>
</tr>
<tr>
<td>3.245</td>
<td>2.920</td>
<td>-325</td>
<td>VI-81</td>
</tr>
<tr>
<td>8.453</td>
<td>12.090</td>
<td>3.637</td>
<td>43</td>
</tr>
<tr>
<td>2.400</td>
<td>2.210</td>
<td>-190</td>
<td>8</td>
</tr>
<tr>
<td>38.100</td>
<td>49.530</td>
<td>11.430</td>
<td>30</td>
</tr>
<tr>
<td>8.000</td>
<td>30.000</td>
<td>22.000</td>
<td>275</td>
</tr>
<tr>
<td>12.040</td>
<td>18.060</td>
<td>6.020</td>
<td>50</td>
</tr>
<tr>
<td>14.999</td>
<td>38.848</td>
<td>23.849</td>
<td>159</td>
</tr>
<tr>
<td>497</td>
<td>1.072</td>
<td>575</td>
<td>116</td>
</tr>
<tr>
<td>27.156</td>
<td>34.705</td>
<td>7.629</td>
<td>28</td>
</tr>
<tr>
<td>20.018</td>
<td>35.207</td>
<td>14.389</td>
<td>69</td>
</tr>
<tr>
<td>41.569</td>
<td>77.485</td>
<td>35.916</td>
<td>86</td>
</tr>
<tr>
<td>16.926</td>
<td>71.461</td>
<td>54.535</td>
<td>322</td>
</tr>
<tr>
<td>28.393</td>
<td>50.265</td>
<td>21.872</td>
<td>77</td>
</tr>
<tr>
<td>350</td>
<td>1.003</td>
<td>653</td>
<td>186</td>
</tr>
<tr>
<td>51.000</td>
<td>295.514</td>
<td>244.514</td>
<td>479</td>
</tr>
<tr>
<td>2.180</td>
<td>10.852</td>
<td>8.672</td>
<td>398</td>
</tr>
<tr>
<td>120</td>
<td>245</td>
<td>125</td>
<td>104</td>
</tr>
<tr>
<td>1.000</td>
<td>10.413</td>
<td>9.413</td>
<td>941</td>
</tr>
<tr>
<td>125.585</td>
<td>154.470</td>
<td>28.885</td>
<td>23</td>
</tr>
<tr>
<td>8.500</td>
<td>159.631</td>
<td>151.131</td>
<td>1.778</td>
</tr>
<tr>
<td>TOTAL:</td>
<td>1.056.323</td>
<td>644.730</td>
<td>147</td>
</tr>
</tbody>
</table>

---

**TOTAL:**

262

---

**TOTAL:**

1.056.323
<table>
<thead>
<tr>
<th>EMPRESA</th>
<th>ACTIVIDAD</th>
<th>VALOR NOMINAL</th>
<th>PARCIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td>PALMORIENTE</td>
<td>Aceite de palma</td>
<td>684</td>
<td>7.3</td>
</tr>
<tr>
<td>FROIDEPORT</td>
<td>Cuartos fríos</td>
<td>10</td>
<td>50.0</td>
</tr>
<tr>
<td>PROCESA</td>
<td>Cauchos fríos</td>
<td>29</td>
<td>31.0</td>
</tr>
<tr>
<td>FINANCIERA GUAYAQUIL</td>
<td>Financiera</td>
<td>4</td>
<td>0.2</td>
</tr>
<tr>
<td>FERTISA</td>
<td>Fertilizantes</td>
<td>.99</td>
<td>23.3</td>
</tr>
<tr>
<td>PISCIFACTORIA MOJANDA</td>
<td>Aluviones de trucha</td>
<td>3</td>
<td>50.0</td>
</tr>
<tr>
<td>LA CEMENTO NACIONAL</td>
<td>Cemento gris</td>
<td>11.929</td>
<td>47.0</td>
</tr>
<tr>
<td>PARQUE IND. RIOBAMBA</td>
<td>Urbanizaciones de lote</td>
<td>29</td>
<td>18.0</td>
</tr>
<tr>
<td>CHAPAS Y MADERAS</td>
<td>Madera</td>
<td>913</td>
<td>99.7</td>
</tr>
<tr>
<td>AZTRA</td>
<td>Azúcar</td>
<td>11.764</td>
<td>98.7</td>
</tr>
<tr>
<td>CODABE</td>
<td>Alcohol</td>
<td>368</td>
<td>99.7</td>
</tr>
<tr>
<td>SELVA ALEGRE</td>
<td>Cemento gris</td>
<td>3.995</td>
<td>46.2</td>
</tr>
<tr>
<td>HOTEL COLON</td>
<td>Turismo</td>
<td>324</td>
<td>15.0</td>
</tr>
<tr>
<td>ENSEMILLAS</td>
<td>Semillas certificadas</td>
<td>38</td>
<td>16.5</td>
</tr>
<tr>
<td>IDAEL ALAMBREC</td>
<td>Alambre de púas</td>
<td>314</td>
<td>20.0</td>
</tr>
<tr>
<td>CEMENTO CHIMBORAZO</td>
<td>Cemento gris</td>
<td>14</td>
<td>0.8</td>
</tr>
<tr>
<td>ECUACARDOSA</td>
<td>Achiote y jengibre</td>
<td>36</td>
<td>50.0</td>
</tr>
<tr>
<td>ECUISIDER</td>
<td>Siderúrgica</td>
<td>26</td>
<td>27.0</td>
</tr>
<tr>
<td>ARTEPRÁCTICO</td>
<td>Muebles</td>
<td>561</td>
<td>16.6</td>
</tr>
<tr>
<td>PROM. TURIS...CAS BOLIVAR</td>
<td>Turismo</td>
<td>1</td>
<td>10.0</td>
</tr>
<tr>
<td>BOLSA DE VALORES QUITO</td>
<td>Financiera</td>
<td>33</td>
<td>32.1</td>
</tr>
<tr>
<td>BOLSA DE VALORES GUAYAQUIL</td>
<td>Financiera</td>
<td>62</td>
<td>77.0</td>
</tr>
</tbody>
</table>
LIST OF INTERVIEWS

USAID, Ecuador

Charles Costello, Mission Director
Michael Deal
Kent Eaton
Randy Reed
Milton Nuñez
Guillermo Jauregui
Aida Lafebre
Wayne Camard

CENDES

Herman Hiño
Luis Armijo

Ing. Victor Salgado
Asesor del Subsecretario de Electrificacion
Ministerio de Energía y Minas

Bolsa de Valores

John Savage
Econ. Section
U.S. Embassy

Sr. Rodrigo Moscoso, CFN

Sr. Ramiro Crespo, INVESTBAN

Dr. Polit
Lawyer for petroleum companies

Duty Greene and Esteban Chiriboga, IDEA

Dr. Franklin Maiguashca
Asesor Economico de la Presidencia de la Republica

Ing. Edison Ortiz, FILANBANCO

Econ. Jaime Egas
Superintendencia de Companias

Econ. Elsa de Mena
Asesora Financiera
Empresa de Agua Potable

Dr. Manuel Vivanco
Director, FEDEXPOR
Ing. Rodrigo Lucio-Paredes  
Director, CENDES

Ing. Jorge Anhauser, CETUR

Econ. Fabian Albuju Chaves  
Superintendencia de Companias

Lic. Diego Hidalgo  
Director Desarrollo Administrativo, SENDA

Sr. Marcel Laniado  
Banco del Pacifico

Dr. Henry Raad  
Chamber of Industry of Guayaquil

Walter Spurrier  
Editor of "Weekly Analysis"

Modesto Correa  
President of the Guayaquil Stock Exchange

Jacinto Jouvin  
President of Ecuatoriana

Franklin Proano  
Gerente Division Tecnica  
Banco Central del Ecuador

Dr. Socrates Navas Mendoza  
Presidente Banco Nacional de Fomento

Jorge Davalos  
Gerente General Banco Nacional de Fomento

Ing. Gustavo Pinto  
Gerente Hilos Pinto

Ing. Antonio Gaybor  
Director de Planificacion, ENAC

Coronel Marco Mino Montalvo  
Director, DINE

Raul Maldonado  
Director of Planning, INECEL

Alfredo Maldonado, UNDP
BIBLIOGRAPHY

DINE, Revista, No. 05, December, 1986.


Reynolds, Clark W. and Wayne Camard, "Obstacles to Competition and Entrepreneurship in Andean Countries: Implications for Regional Integration from the Ecuador Case," Stanford University, June 25, 1990.


Corporación Financiera Nacional, "Memoria 1989."


Superintendencia de Compañías, "Informe de Labores, 1988-89."


Egas Vasco, Jaime, "La Concentración de la Riqueza en el Sector Societario Ecuatoriano, mimeo, no date.


Weekly Analysis, Walter Spurrier, Editor, various numbers.