ECUADOR

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators

(Billions of U.S. Dollars unless otherwise indicated)

	1996	1997	1998 1/
Income, Production and Employment:			
Nominal GDP	19.0	19.8	19.9
Real GDP Growth (pct)	2.0	3.4	1.0
GDP by Sector:			
Agriculture, Fishing	3.5	4.1	0.4
Petroleum, Mining	-1.9	3.5	0.1
Manufacturing	3.3	3.5	2.7
Commerce, Hotels	4.4	3.3	2.1
Finance, Business Services	1.9	1.9	2.5
Government, Other Services	0.5	1.3	1.7
Per Capita GDP (US$)	1,638	1,665	1,618
Labor Force (estimate - 000s)	3,220	3,374	3,441
Urban Unemployment (pct)	10.0	9.3	N/A
Money and Prices (annual percentage growth):			
Money Supply (M2) 2/	43.9	35.0	22.3
Consumer Price Inflation	26.0	30.7	45.0
Exchange Rate (Sucres/US$ annual average)			
Central Bank	3,190	4,000	5,700
Market	3,190	4,070	5,800
Balance of Payments and Trade:			
Total Exports FOB 3/	4.9	5.3	2.8
Exports to U.S. 3/	1.9	2.0	1.1
Total Imports CIF 3/	3.9	2.2	3.7
Imports from U.S. 3/	1.2	1.5	1.1
Trade Balance 3/	1.2	3.1	-0.9
Balance with U.S. 3/	2.7	0.5	0.0
External Public Debt	12.6	12.6	12.7
Debt Service Payments/GDP (pct)	22.3	27.7	21.0
Current Account Deficit/GDP (pct)	0.6	-3.8	-2.4

Fiscal Balance/GDP (pct)	-4.0	-2.5	-5.9
Gold and Foreign Exchange Reserves	1.8	2.1	1.8
Aid from U.S. (FY-US$ millions)	13.5	11.5	12.5
Aid from Other Sources (US$ millions)	N/A	N/A	N/A

1/ 1998 figures are estimates based on data available in August.
2/ 1998 figure is for August 1997-August 1998.
3/ All 1998 figures are for the period January-August.

Source: Ecuadorian Government and Central Bank of Ecuador data.

1. General Policy Framework

The Ecuadorian economy is based on petroleum production, along with exports of bananas, shrimp and other primary agricultural products. Industry is largely oriented to servicing the domestic market but is becoming more export-oriented. During the oil boom of the 1970s, the government borrowed heavily from abroad, subsidized consumers and producers, and expanded the state's role in economic production. These policies led to chronic macroeconomic instability in the 1980s.

The 1992-1996 government of Sixto Duran-Ballen sought to stabilize the economy, modernize the state, and expand the role of the free market. By 1994, a sound macroeconomic program had resulted in a balanced budget and reduced inflation. Those accomplishments were undermined by a series of shocks during 1995, including the outbreak of fighting on the border with Peru, a corruption scandal and political crisis involving the then-Vice President, and several months of electricity rationing. The problems resulted in skyrocketing interest rates, a growing number of past-due loans, and the failure of a major financial institution. GDP growth slowed during 1995, increasing by only 2.3 percent instead of a projected 4 percent. The uncertainty associated with the 1996 elections, the rise of the populist Abdala Bucaram to the presidency, poor treatment of foreign investors, and delays in the announcement of the new government's economic program helped prevent an economic recovery. Economic reform stalled under Bucaram's six-month government (August 1996-February 1997) which was characterized by increased corruption and decreased investment.

The interim government of Fabian Alarcon (February 1997 - August 1998) was faced with a number of challenges, including implementing the Duran-Ballen era reforms, falling oil prices, and coastal devastation from El Niño. However, the Alarcon government failed to privatize the state-owned telephone company, reduce the inflation rate to international levels, or improve the electricity generating sector. The current administration of Jamil Mahuad has moved quickly to secure a peace treaty with Peru, allowing the government to begin concentrating on Ecuador's economic problems. In September 1998, President Mahuad cut politically sensitive subsidies on cooking gas and electricity as a first step toward reducing Ecuador's large fiscal deficit. In addition to cutting the fiscal deficit, the Mahuad administration also hopes to increase foreign investment, sell off state-owned enterprises, increase private investment in the oil sector, and rebuild much of the country's infrastructure.

The government estimates that the fiscal deficit for 1998 will reach between 5.5 and 6.0 percent of GDP. Significant revenue and expenditure measures will be needed to reduce the deficit to what the government believes is a sustainable figure of 2.5 percent of GDP in 1999. Public sector expenditures (including state enterprises but excluding the military's capital budget, which is funded by a direct off-budget allocation of oil revenues) accounted for 18.6 percent of

GDP in 1997. Debt service is the largest area of government spending (accounting for about half of central government expenditures), followed by education, defense and agriculture. The government remains highly dependent on revenue from oil exports and customs charges.

The central bank attempts to smooth out fluctuations in liquidity through weekly bond auctions and interventions in the secondary market but no longer uses bank reserve requirements as a monetary tool. During periods of capital inflows, the government compensates for the inflationary effects of foreign exchange influx by increasing its sucre deposits at the central bank. Annual M2 percentage growth in 1996 increased from 42 percent to 44 percent. The August 1996 - August 1997 growth rate was 28 percent. The Duran-Ballen policy of depreciating the currency at a rate slower than inflation helped reduce the annual increase in consumer prices from 60 percent in 1992 to 23 percent in 1995. However, the inflation rate rose to 26 percent in 1996, 30 percent in 1997, and will likely reach 45 percent in 1998. In late Fall of 1998, the effects of the international financial crisis and local U.S. Dollar illiquidity (combined with efforts to protect the local currency) pushed nominal interest rates on sucre loans toward 90 percent.

2. Exchange Rate Policy

The monetary authorities introduced a narrow, pre-announced exchange rate band in December 1994. As a result of market pressures, the band has been adjusted periodically. The central bank devalued the sucre by 7.5 percent in March 1998 and again by 10 percent in September 1998 (while substantially broadening the band itself by 15 percent).

Foreign currency is readily available on the free market, trading at 6,600 sucres to the dollar by November 1998. Although some government officials have criticized currency speculators, there are no restrictions on the movement of foreign currencies into or out of Ecuador. By the end of October 1998, foreign exchange reserves amounted to about $1.65 billion (down 25 percent from January 1998), enough to cover imports for approximately four months.

3. Structural Policies

Recent administrations have enjoyed only partial success in carrying out structural reforms designed to promote investment and economic growth. Progress has been made on budget reform, reduction of public employment levels, and elimination of some unnecessary and market-distorting regulations. With exceptions for pharmaceuticals, some foodstuffs and fuels, prices are now set by the free market. New laws have established a basis for the development of equity capital markets, modern regulation of financial institutions, and improvement in the security of agricultural land tenure for both peasants and agribusiness. In most cases, however, implementation has lagged behind legislation. The Mahuad government has placed great emphasis on structural reforms, including revamping the tax system and privatizing state-owned enterprises, such as telecommunications and power generation.

The 1993 State Modernization Law allowed private sector participation in "strategic sectors" of the economy, including petroleum, electricity and telecommunications, but only on a concession basis. The National Modernization Council (CONAM) has sought to promote privatization, and the state development banks have sold much of their equity shares in commercial enterprises to the private sector. In the past, the armed forces have expressed interest in selling some shares in military-owned companies to private sector partners, though Ecuador's recent economic problems may delay any such sales. The Mahuad administration has put forth an ambitious plan to privatize much of the state-owned companies by the year 2000. Of key importance in the schedule is the sale of the two state-owned telephone companies (Andinatel and Pacifictel) in the third quarter of 1999. The Mahuad administration has asked foreign oil companies operating in Ecuador to build, own, and operate a second oil pipeline from the Amazon jungle to the Pacific Ocean. If the companies agree, construction could begin in April 1999. Steps have been taken toward granting private concessions for public works, the civil registry, airports, ports, and postal and railroad services. The government will also need to address the need for major reform of public education and the social security system's insolvent pension program.

Investment liberalization measures in 1991 and 1993 provided foreign investors with full national treatment and eliminated prior authorization requirements for investment in most industries, including finance and the media. Specific restrictions, most applicable to Ecuadorian as well as foreign investors, remain for petroleum, mining, electricity, telecommunications and fishing investments. A Bilateral Investment Treaty with the United States that provides for free transfers and a binding arbitration dispute settlement procedure entered into force in May 1997. A value-added tax of 10 percent applies to imports and sales of goods and services in the formal sector. An excise tax on certain products continues to be applied to imports in a discriminatory manner. Also, congress recently passed legislation that replaces the income tax with a one percent tax on financial transactions. Although the hydrocarbons law is relatively investor-friendly, recent administrations have failed to respect many existing contracts with foreign investors in the oil sector.

4. Debt Management Policies

As of mid-1998, Ecuador's external public debt was $12.7 billion, roughly the same level as the previous year. While expressing a desire to reduce the debt burden, President Mahuad has promised to honor Ecuador's obligations.

In February 1995 Ecuador completed a comprehensive restructuring of its $7.1 billion external commercial bank debt and associated arrears. Service on the commercial debt should average about 1.7 percent of GDP through the year 2000, but will rise thereafter unless the government takes steps to retire some of its debt stock. Ecuador concluded bilateral rescheduling agreements with most of its official creditors under a 1994 Paris Club agreement but again ran substantial bilateral arrears in 1995-1998 and has stated its intention to seek another Paris Club rescheduling. During 1996 Ecuador failed to meet the targets of the IMF-monitored program that replaced the 1994 standby arrangement, with which Ecuador had quickly fallen out of compliance. As of November 1998, Ecuador is seeking another IMF program in order to reschedule Paris Club debt and unlock conditioned loans from international financial institutions.

5. Significant Barriers to U.S. Exports

Ecuadorian trade policy was substantially liberalized during the early 1990's, resulting in a reduction of tariffs, elimination of most non-tariff surcharges, and enactment of an in-bond processing industry (maquila) law. The Duran-Ballen administration continued the move towards open trade by concluding bilateral free trade agreements with its Andean Pact partners. After two years of negotiations with its major trading partners, Ecuador joined the World Trade Organization (WTO) in January 1996.

Duties and fees for most imports into Ecuador fall in the 5 to 20 percent range. Ecuador agreed to an Andean Common External Tariff in February 1995. Special exemptions allow Ecuador to continue to charge higher rates for about half of the items on the common tariff schedule.

Customs procedures can be difficult but are not normally used to discriminate against U.S. products. The Mahuad administration is moving to repair damage done to customs services that occurred under previous administrations by focusing on corruption and improving efficiency. The government has yet to implement its commitment not to use sanitary and phytosanitary restrictions to block the entry of certain imports of consumption products and agricultural goods from the United States, but has increased the number of Ecuadorian institutions that are authorized to issue sanitary and phytosanitary permits. Import bans on used clothing, used cars and used tires have yet to be eliminated, despite Ecuador's promise in its WTO accession protocol to do so by July 1996. Andean Pact price bands that result in high effective tariffs for a variety of agricultural products are to be phased out. The government no longer sets minimum prices for assessing customs duties on certain imports.

All importers must obtain a prior import license from the central bank, obtainable through private banks. Licenses are usually made available for all goods. A 1976 law that prevented U.S. and other foreign suppliers, but not domestic suppliers, from terminating existing exclusive distributorship arrangements without paying compensation was repealed in September 1997. However, the U.S. Government is concerned that the discriminatory law will continue to be applied in pending court cases or against U.S. companies that have existing contracts that were in force prior to the repeal. Foreigners may invest in most sectors, other than public services, without prior government approval. There are no controls or limits on transfers of profits or capital, and foreign exchange is readily available.

Government procurement practices are not sufficiently transparent but do not usually discriminate against U.S. or other foreign suppliers. However, bidding for government contracts can be cumbersome and time-consuming. Bids for public contracts are often delayed or canceled. Many bidders object to the requirement for a bank-issued guarantee to ensure execution of the contract.

6. Export Subsidies Policies

Ecuador does not have any explicit export subsidy programs.

7. Protection of U.S. Intellectual Property

Ecuador belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO), and is a signatory to the Berne Convention, Rome Convention, and the Phonograms Convention. In 1998, the U.S. Trade Representative maintained Ecuador on the “Special 301” Priority Watch List.

Ecuador’s protection of intellectual property is based primarily on the 1998 Intellectual Property Law, which protect patents, trademarks, copyrights, and plant varieties. The law generally meets the standards specified in the WTO TRIPs Agreement. Although a November 1996 Andean Pact court decision overturned Ecuadorian regulations that provided transitional or “pipeline” protection for previously unpatentable products, in 1998, the Alarcon government approved 12 “pipeline” patents. Approximately 37 such patents held by U.S. firms still await final resolution under the Mahuad government.

In October 1993, Ecuador and the United States signed a bilateral Intellectual Property Rights Agreement (IPRA) that guarantees full protection for copyrights, trademarks, patents, satellite signals, computer software, integrated circuit layout designs, and trade secrets. Although the Ecuadorian Congress has not yet ratified the IPRA, in 1998, it enacted legislation that generally harmonizes local law with the agreement’s provisions (except “pipeline” patents).

Although enforcement of intellectual property rights has improved in Ecuador, copyright infringement occurs, and there is widespread local trade in pirated audio and video recordings, as well as computer software. However, companies can seek preliminary injunctive relief under the 1998 IP law. Local registration of unauthorized copies of well-known trademarks has been a problem in the past, but monitoring and control of such registrations have improved. Some local pharmaceutical companies produce or import patented drugs without licenses and have sought to block improvements in patent protection.

8. Worker Rights

a. The Right of Association: Under the Ecuadorian Constitution and labor code, most workers in the parastatal sector and private companies enjoy the right to form trade unions. Public sector workers in non-revenue earning entities, as well as security workers and military officials, are not permitted to form trade unions. Less than 12 percent of the labor force, mostly skilled workers in parastatal and medium-to-large sized industries, is organized. Except for some public servants and workers in some parastatals, workers by law have the right to strike. Sit-down strikes are allowed, but there are restrictions on solidarity strikes. Ecuador does not have a high level of labor unrest. Most strike activity involves public sector employees.

b. The Right to Organize and Bargain Collectively: Private employers with more than 30 workers belonging to a union are required to engage in collective bargaining when requested by the union. The labor code prohibits discrimination against unions and requires that employers provide space for union activities. The labor code provides for resolution of conflicts through a tripartite arbitration and conciliation board process. Employers are not permitted to dismiss permanent workers without the express permission of the Ministry of Labor. The in-bond (maquila) law permits the hiring of temporary workers in maquila industries, effectively limiting unionization in the sector. Employers consider the labor code to be unfavorable to their interests.

c. Prohibition of Forced or Compulsory Labor: Compulsory labor is prohibited by both the constitution and the labor code, and is not practiced.

d. Minimum Age for Employment of Children: Persons less than 14 years old are prohibited by law from working, except in special circumstances such as apprenticeships. Those between the ages of 14 and 18 are required to have the permission of their parents or guardian to work. In practice, many rural children begin working as farm laborers at about 10 years of age, while poor urban children under age 14 often work for their families in the informal sector.

e. Acceptable Conditions of Work: The labor code provides for a 40-hour workweek, two weeks of annual vacation, a minimum wage and other variable, employer-provided benefits such as uniforms and training opportunities. The minimum wage is set by the Ministry of Labor every six months and can be adjusted by Congress. Mandated bonuses bring total monthly compensation to about $137. The Ministry of Labor also sets specific minimum wages by job and industry so that the vast majority of organized workers in state industries and large private sector enterprises earn substantially more than the general minimum wage. The labor code also provides for general protection of workers' health and safety on the job, and occupational health and safety is not a major problem in the formal sector. However, there are no enforced safety rules in the agriculture sector and informal mining.

f. Worker Rights in Sectors with U.S. Investment: The economic sectors with U.S. investment include petroleum, chemicals and related products, and food and related products. U.S. investors in these sectors are primarily large, multinational companies which abide by the Ecuadorian Labor Code. In 1996 there were no strikes or serious labor problems in any U.S. subsidiary. U.S. companies are subject to the same rules and regulations on labor and employment practices governing basic worker rights as Ecuadorian companies.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis -- 1997

(Millions of U.S. Dollars)

Category		Amount
Petroleum		730
Total Manufacturing		193
Food & Kindred Products	62	
Chemicals & Allied Products	55	
Primary & Fabricated Metals	3	
Industrial Machinery and Equipment	0	
Electric & Electronic Equipment	1	
Transportation Equipment	15	
Other Manufacturing	57	
Wholesale Trade		67
Banking		(1)
Finance/Insurance/Real Estate		23
Services		3
Other Industries		(1)
TOTAL ALL INDUSTRIES		1,175

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.