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The Nation

Filanbanco To Be Liquidated

Late in July, the Noboa administration announced that it had decided to liquidate Filanbanco, a decision that had been long awaited. Some confusion remains, however, said Analytica Securities' *Ecuador Weekly Report*, in particular over how former clients will be reimbursed in the future. Contradictory statements by top officials early in August served only to heighten the uncertainty.

Deposit Guarantee Agency Chairman Miguel Davila announced that reimbursement of former depositors would start in about three months and that one of the Filanbanco trust funds has already saved \$20 million that can be used immediately to refund creditors and former clients.

At the same time, however, chief liquidator Ximena Montenegro was insisting that all further refunds must wait for the liquidation process to move ahead. She will not authorize any reimbursements at present, as they would interfere with legal steps in the context of liquidation.

If the liquidator's position is correct, it will be a heavy blow to former clients, who had hoped that their money would be returned soon. The liquidation process normally takes about five years.

Moreover, there is uncertainty about how the refunds will be made: Davila says in hard cash, but Montenegro says sovereign bonds. Authorities also disclosed that \$5 million in Filanbanco assets have been transferred to Filanfondos, a former Filanbanco subsidiary, which may lend the money to investors willing to put it into expansion projects.

In the meantime, Filanbanco remains closed while the liquidator examines the bank's records and accounts and all available information on the bank's real and present status. No date has been announced for a resumption of operations.

Privatization

Ecuador plans to try again to sell the infrastructure and concession for power distribution in Guayaquil, which consumes 31% of the country's electricity. President Noboa ordered the deposit guarantee agency and the national electricity council to outline plans for the sale by August 30. The concession, which the council valued at \$118 million, was owned by Empresa Eléctrica del Ecuador until the state seized it in 2000, when the company failed to pay for power supplies.

"We want to turn Emelec back to private hands," said Diego Pérez, head of Ecuador's national electricity council. "This will be a completely private enterprise in which the state plays no part." He added that the sale may begin before the end of the current presidential administration in January.

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Luncheon in Honor of Walter Spurrier Publisher and Editor of *Análisis Semanal/Weekly Analysis* July 23, 2002, at the Harvard Club

Cosponsored by American Airlines, Baltek Corporation, and Bear Stearns & Co.

At this moment, Spurrier reminded his audience, there are no formal candidates for the October 20 election. The one significant event so far is that León Febres Cordero has decided not to run, which recasts the political scenarios.

The leading candidate is Alvaro Noboa, who can thank Febres Cordero for not forcing him to negotiate with Abdalá Bucaram. Noboa does not need Bucaram's backing to hold his own against any of the possible candidates who remain in the field. Noboa has a strong base in the countryside arising from his sponsorship of medical clinics in rural areas. There seems little doubt at this juncture that Noboa will reach the runoff poll a month after the general election.

Bucaram, on the other hand, has to weigh his options; he will probably support the candidacy of his brother, Jacobo. Bucaram has access to a good deal of U.S. philanthropy, and has a lot of "soft" support based on what people think he could do. He should also be considered a good possibility to reach the runoff.

Rodrigo Borja is another likely candidate, but he has not changed his ideas from the '70s statist model under which he governed a generation ago. He has support, but people are unlikely to gravitate toward him.

The last possible candidate Spurrier considered was Lucio Gutiérrez, who is gaining support among small leftist parties. He engineered the coup that ousted Mahuad, and patterns his policy on that of Venezuela's Hugo Chávez.

The national economy at present appears to be in good shape. The government's target for GDP growth this year is 4%, and it seems likely. With no major economic upsets, the economy could be back to pre-1999 levels by the end of next year. Inflation is under control and declining, and oil production could double within a year, producing windfall revenues that could take care of debt service.

Unfortunately, since in the short term Ecuador has



From left: EAA Director Arthur Byrnes of Deltec Asset Management; Walter Spurrier; Amb. Hernán Holguín, Consul General of Ecuador in New York; Xavier Escala of Hedge Securities, representing Bear Stearns; and EAA Vice President Jacques Kohn of Baltek Corporation. Photo by Linda Calvet.

no access to international markets, it must produce a surplus in order to amortize its debt, or win an agreement with the IMF to secure new loans. The public payroll has shot up in recent months, and under dollarization a devaluation is no longer possible, so an IMF accord is less likely.

And there are two significant weaknesses in view: new oil may not be forthcoming for the new pipeline, and the cost of doing business in Ecuador is rising. For the former, the results of a costly exploration drive were disappointing, and the pipeline consortium is cutting back on its investment. A revenue bonanza is therefore unlikely.

Dollarization, looking at the latter problem, has driven up the costs of doing business, and little is being done to make Ecuador more competitive. There is a risk that Ecuador will lose the productive parts of its economy—its tradeable activities—to its neighbors.

The potential candidates are saying nothing about these problems, largely because they don't know about them. When they find out, after one of them is elected, he will look for an IMF accord. But the IMF will want austerity, which will be wildly unpopular. There are no easy solutions.

THE NATION

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The government first tried to sell the concession in May. Argentina's Pecom Energía SA, Spain's Unión Eléctrica Fenosa SA, and U.S.-based AES Corp. qualified to bid and then dropped out. At that time, the government had a base price of \$130 million.

The government plans to use the proceeds from the sale to pay back ex-depositors of failed Banco del Progreso. Fernando Aspiazu, who was convicted of bank fraud and is serving a nine-year jail sentence, owned both companies.

Free Trade Talks

Early in August, Canada said that it planned to negotiate a free-trade agreement with five Andean countries, including Ecuador. Trade between Canada and Venezuela, Colombia, Ecuador, Peru, and Bolivia was worth C\$3.6 billion (US\$42.3 billion) last year, the Trade Department told Bloomberg—about the same as the value of goods that cross the U.S.-Canada border every three days.

The announcement came a day after U.S. President George W. Bush declared that freer trade with Latin American countries was one of his top priorities. Canada already has trade accords with Chile and Costa Rica, and is talking to groups of Central American and Caribbean nations.

Foreign Commerce Ministry

Richard Moss, foreign commerce minister, resigned early in August to become general director of the Andean Community, President Noboa announced. Moss will occupy the second-highest post in the five-country trade organization. He has defended Ecuador's membership in the trade bloc against several business groups that have recently called for Ecuador's withdrawal from it. "He can now fight for Ecuador from inside," the president said.

Foreign Relations Minister Heinz Moeller will take over Moss's previous responsibilities, as well as remain in his current post, until a replacement is named.

Pipeline Consortium

OCP Ecuador SA, which is building a \$1.1 billion pipeline, will be led by EnCana Corp. executive Andy Patterson, in a move designed to give shareholders more control, said Bloomberg. He will replace Hernán Lara, who plans to resign August 16.

Patterson is senior vice president in charge of Latin America at EnCana, one of the member companies; it

used to be known as Alberta Energy Co. Ltd.

The pipeline is slated to begin operating in September 2003, transporting at least 80,000 barrels a day. Analysts expect it to generate \$800 million for the government during its first 20 years of operation.

Other members of OCP Ecuador SA include Occidental Petroleum Corp., Kerr-McGee Corp., Spain's Repsol-YPF SA, and Agip Ltd. of Italy.

According to the *Financial Times*, the pipeline's planned capacity will have to be reduced by half because shareholders cut investment after a dispute with the government over value-added tax refunds. The shareholders say they are owed \$200 million in tax rebates.

And according to *Ecuador Weekly Report*, the Anti-corruption Commission has uncovered "serious legal and ethical breaches" in the project. Problems are said to exist with contracting procedures, oversight, and construction operations. The company and its officials are also blocking the investigation, the commission charges.

Ecuadorean Airline

LanChile SA plans to create an Ecuadorean airline in order to add routes and expand its cargo service. General Manager Luis Ernesto Videla said the carrier could begin operating within two months, pending approval of Ecuador's national aviation council.

"We are trying to create an Ecuadorean company, an airline called LanEcuador," Videla said during an interview with TV station Teleamazonas.

LanChile is counting on the Ecuadorean unit to boost shipments of cargo to the United States, Videla said. LanChile began flights between Guayaquil and Miami and New York in 2000.

The Economy

Foreign-Currency Reserves

The nation's foreign-currency reserves rose 3.1% to \$1.16 billion for the week ending August 10, according to figures released by the Central Bank.

Tax Collections Rise

Ecuador's tax revenue rose 6.7% in July, the smallest increase so far this year—down from 40% in January, said Bloomberg.

Taxes collected rose to \$251.61 million from \$235.87 million a year earlier, according to the tax authority. Revenue during the first six months of the year was \$1.64 billion, 15% above the target of \$1.43 billion. In January, tax revenue rose 40% from a year earlier.

"It's impossible to maintain that type of growth every month," said Mauricio Pozo of Multienlace, a Quito-based economic consultancy. "Eventually this should level out to grow at about the same level as inflation."

Ecuador has been collecting more taxes since April 2000, when Congress gave the internal revenue service more power to punish tax evaders. Taxes are the top source of revenue for the government and are expected to generate \$2.5 billion this year, or about half the nation's \$5.6 billion budget.

The government's plan to sell a concession for the customs service may trigger another jump in tax revenue since there has been little tax collection from that source, said Pozo.

Collection of the value-added tax, Ecuador's main tax, rose 3.9% to \$140.7 million from \$135.5 million the previous year.

IMF Negotiations

According to *Ecuador Weekly Report*, the Noboa government and the IMF will make "yet another effort" to unblock negotiations over a new standby agreement before the end of this year. A new Fund mission is expected in Quito this week and Economy Minister Francisco Arosemena is insisting that after the liquidation of Filanbanco Ecuador has already fulfilled most IMF conditions for a new letter of intent. The mission will engage in a new review of public finances. Under the terms of the agreement being negotiated, Ecuador could receive a \$240 million loan that would help shore up the troubled fiscal outlook. The Noboa administration has recently moved to comply with IMF conditions (honoring Paris Club obligations, appointing a "debt czar," and liquidating Filanbanco). The Treasury, however, has yet to present credible plans to reduce spending. The threat of a massive budget deficit and the projected inability of the government to produce a 6.5% primary surplus in the government accounts are still clouding discussions with the IMF.

According to analysts, public spending has skyrocketed during the last few months due (1) to President Noboa's "excessive willingness" to bow to mounting social, local, and sectional pressures, (2) to the inability of the executive to control patronage and corruption in several key ministries, (3) to major salary increases in the public sector, and (4) to an enhanced military and security budget.

Arosemena promised the Fund that he would soon present a new plan to bring the budget under control, but no details had been offered by early August. Some observers fear that the only alternative is to cut civil serv-

ice salaries, which were only recently increased. This could, however, trigger a major social outburst and lead to massive strikes and protests that could paralyze the nation's public administration. Making the problem worse is the fact that most of the nation's civil servants are grossly underpaid and live in poverty and destitution.

According to Central Bank chairman Mauricio Yépez, the projected deficit for fiscal year 2002 is \$500 million. The IMF standby loan is necessary in order to help Ecuador fulfill its primary surplus commitments. Local officials hope that a successful conclusion of the current negotiations will open the doors for other international loans coming from the Inter-American Development Bank, the Andean Development Corporation (CAF), and the World Bank. All these organizations have suspended loans to Ecuador pending IMF approval.

In a related story, the IMF is reported to have set a target for GDP growth in Ecuador of 3.5–4.0% next year, with single-digit inflation. The information came from Central Bank governor Leopoldo Báez.

Trade Balance

The nation's trade deficit rose in June as exports declined. The deficit was \$123 million, up from a revised \$92 million in May and \$27 million a year earlier, the Central Bank said in a statement.

The trade deficit has increased as growth in the economy has spurred demand for imports. A decision by Ecuador to use the dollar as the national currency two years ago has also made it harder for nonpetroleum exports to compete with similar goods sold by other countries, economists said.

"The recent month-to-month drop in nonpetroleum exports is due to the fact that we can't compete on price with many exports," said María de la Paz, an economic analyst with Multiplica. "This negative trade balance is not sustainable in the long run because it becomes a threat to our dollarized economy."

The trade deficit this year may rise to \$1.2 billion from \$302 million in 2001 and a surplus of \$1.5 billion in 2000, de la Paz said.

June exports fell to \$399 million from a revised \$436 million in May and rose from \$397 million a year earlier. Nonpetroleum exports dropped to \$221 million in June from \$267 million in May and \$228 million a year earlier. Petroleum-based exports rose to \$178 million in June from \$169 million in May and \$143 million a year earlier.

From January to June, Ecuador had a \$592 million trade deficit, compared with a \$138 million trade surplus in the same period last year.