



ECUADOR

BUSINESS FRAMEWORK CONDITIONS & ADVOCACY PRIORITIES OF THE WBCSD-SNV ALLIANCE

CONTEXT

In the framework of the WBCSD-SNV Alliance, the Council's Regional Network partner in Ecuador, the Consejo Empresarial para el Desarrollo Sustentable (CEMDES), and SNV's national office are responsible for the implementation of the established strategies. For that matter, they liaise with and involve key actors such as the local business sector, national government agencies, development agencies, and NGOs.

While the Alliance works on moving inclusive business ideas identified by local and multinational companies towards investment cases, it also engages with business and societal stakeholders at the national level to identify the critical challenges and develop common advocacy messages to address regulatory hurdles in a collaborative manner.

The key facts and trends with regard to the Ecuadorian business environment are laid out below, in addition to an outline on the Alliance's main advocacy priorities in this country.



Source of the map: CIA World Fact Book

BUSINESS FRAMEWORK CONDITIONS

Basic socio-economic data:

- 13.2 million inhabitants
- Real GDP growth of 4.7% in 2006, growth projected at 4% for 2007 and 3.7% for 2008.
- State spending has been rising 16% per year since 2001
- Creating jobs is a particular concern: between 2001 and 2004, youth unemployment increased from 14.8 % to 21.6% of the total labor force
- Income divide between rural and urban areas: rural poverty levels are nearly double those of urban areas.
- GDP composition by sector (2006):
 - agriculture: 6.3%
 - industry: 33.5%
 - services: 60.2%
- Economic inequality: the richest 10% of the population receives three times more income than the poorest 50% and sixty times more than the poorest 10%.
- Natural resources: petroleum, fish, timber, hydropower
- Agricultural products: bananas, coffee, cocoa, rice, potatoes, manioc (tapioca), plantains, sugarcane; cattle, sheep, pigs, beef, pork, dairy products; balsa wood; fish, shrimp
- Industries: petroleum, food processing, textiles, wood products, chemicals
- Export commodities: petroleum, bananas, cut flowers, shrimp – Ecuador’s substantial petroleum resources have accounted for 40% of the country's export earnings and one-third of central government budget revenues in recent years
- Export partners: US 51.1%, Peru 8%, Germany 4.4%, Colombia 4.3% (2005)

The importance of remittances for the Ecuadorian economy:¹

Total size of remittances in 2005 (in US \$ millions)	Remittances as compared to: (% thereof)		
	Official Development Assistance (2004)	Foreign Direct Investment	Gross Domestic Product
2'005	1084%	131%	6.4%

Political trends:

Political instability: eight presidents have governed Ecuador since 1996, with no single president being able to lead his four-year mandate to its conclusion. The deep-seated politicization of the country’s institutions has impeded coherent policymaking and has thwarted progress on much-needed reforms to bolster the country’s weak infrastructure.

Importance of local government: Ecuador is particularly striking as an example of the ability for local government to profoundly impact local development. Both Quito and Guayaquil, under the leadership of two visionary mayors, have instigated impressive urban redevelopment programs – in old downtown Quito and in the waterfront area of Guayaquil – transforming the physical

¹ Inter-American Development Bank, "Remittances 2005: Promoting Financial Democracy", March 2006 – available online at <http://www.iadb.org/am/2006/doc/StatisticalComparisons.pdf>

appearance of these cities but also opening the door to real business growth and local investment.

The new Ecuadorian President, Rafael Correa, took office on 15 January 2007 after winning 57% of the votes. Most notably, his intentions for Ecuador are:

- to keep the US \$ as the country's currency (introduced as such in early 2000). Although it is likely that dollarization will remain in place during the outlook period, an abandonment of the currency regime in response to a severe external shock cannot be ruled out. This would bring with it heavy economic costs and would seriously destabilize the business environment.
- to set up a Constituent Assembly to rewrite the constitution and with full powers to limit, restructure or dissolve any branch of government, which Correa describes as a "corrupt partyocracy". On 15 April 2007 a referendum was held on calling the assembly after Correa persuaded former President Lucio Gutierrez – a populist politician who developed tight bonds with the United States during his mandate as president (2003-2005) – to throw his weight behind the plans to hold a referendum on constitutional reform. Mr. Gutierrez's Patriotic Society Party won 24 of the 100 seats in congress and the deal has allowed Mr. Correa backed by deputies from nine smaller mainly left-wing parties - to assemble a narrow legislative majority.
- The referendum on whether to hold a new constitutional convention was approved by almost 80%. The yes vote launches Ecuador into its third electoral cycle since November 2006, setting up an election for a constituent assembly later this year. For Mr Correa, whose party has no representatives in the Congress elected last year, this will be critical, enabling him to bypass institutions of government that he views as dominated by his political foes. The major unanswered questions concern what the 130-seat constituent assembly will decide (most likely: limiting the power of Congress, which many Ecuadoreans see as corrupt and adept only at toppling presidents). The assembly should be elected within three months, and then will have six months to draft a new constitution, which will have to be put to another referendum. If a new constitution were to be drafted and approved, it would be the 21st since 1830.
- Correa, whose party does not field any candidates in the legislature because it views the body as rotten and discredited, is facing a Congress controlled by his political opponents. Most notably, with 28 seats out of 100, the largest party in Congress (the Institutional Renewal Party of National Action) is led by Álvaro Noboa, a billionaire and important exporter of bananas interested in conquering the northern American market, and the loser of the last presidential election. Basically, there is opposition from Ecuador's traditional political elites, especially those based in Ecuador's economic capital, Guayaquil.
- to restructure and renegotiate Ecuador's \$10 billion commercial, bilateral and multilateral external debt, equivalent to around 30% of GDP. ("With this level of debt, we cannot move the country forward," he said in December. "A country that spends twice as much on foreign debt as it does on education cannot develop.") But in fact his views have produced uncertainty and confusion: he has refused to rule out an "Argentina-style" default, insisting that any renegotiation will be friendly rather than imposed. The danger for Mr Correa and Ecuador is that the mere threat of default could prompt a financial crisis like the one that hit Argentina in late 2001 (default on US\$ 100 billion debt!) and a run on the banks, putting pressure on the country's dollarized economy and weakening his position as President.
- Correa is looking toward a 75% debt reduction, and plans to use the savings on debt service to increase social spending. However, according to financial analysts, the

government should have ample resources to devote to social spending without jeopardizing debt servicing.

- not to allow the International Monetary Fund to monitor the country's economic plan
- not to not sign a free trade agreement with the United States (unlike its neighbors Colombia and Peru) and not to renew the lease of the US air force base in Manta, the only one the US maintains in Latin America, after it runs out in 2008.
- to increase the state's share of the oil companies' production, without, however, expropriating them ("Many of the oil contracts are a true entrapment for the country. Of every five barrels of oil that the multinationals produce, they leave only one for the state and take four. That is absolutely unacceptable. We're going to revise and renegotiate the contracts.") Mr. Correa has also said he favors rejoining the Organization of the Petroleum Exporting Countries, which Ecuador left in 1992.
- to integrate Ecuador's economy into South American Community of Nations, a wide free trade zone that aims to unite the Andean Community of Nations (CAN) and the Southern Common Market (Mercosur). For the time being, Ecuador is part of the former, a trade bloc comprising the countries of Bolivia, Colombia, and Peru.

Ecuadorian business environment:

The World Bank's "Doing Business" database² provides objective measures of business regulations and their enforcement. The Doing Business indicators are comparable across 175 economies. They indicate the regulatory costs of business and can be used to analyze specific regulations that enhance or constrain investment, productivity, and growth. Ecuador's standings on the World Bank "Doing Business" database, out of a total of 175 countries:

Ease of...	2006 rank	2005 rank	Change in rank
<i>Doing Business</i>	<i>123</i>	<i>120</i>	<i>-3</i>
Starting a Business	139	139	0
Dealing with Licenses	60	61	+1
Employing Workers	161	162	+1
Registering Property	84	106	+22
Getting Credit	65	59	-6
Protecting Investors	135	133	-2
Paying Taxes	53	52	-1
Trading Across Borders	126	124	-2
Enforcing Contracts	96	91	-5
Closing a Business	134	127	-7

² See <http://www.doingbusiness.org/>

In Transparency International's corruption perception index, Ecuador is ranked 138th out of 163 nations evaluated, with a score of 2.3 out of 10.³

A detailed layout of the data presents the Ecuadorian business environment as follows:

ECUADOR		Ease of doing business (rank)		123	
Latin America & Caribbean		GNI per capita (US\$)		2,630	
Lower middle income		Population (millions)		13.2	
Starting a business (rank)	139	Protecting investors (rank)		135	
Procedures (number)	14	Extent of disclosure index (0-10)		1	
Time (days)	65	Extent of director liability index (0-10)		5	
Cost (% of income per capita)	31.8	Ease of shareholder suits index (0-10)		6	
Minimum capital (% of income per capita)	7.7	Strength of investor protection index (0-10)		4.0	
Dealing with licenses (rank)	60	Paying taxes (rank)		53	
Procedures (number)	19	Payments (number per year)		8	
Time (days)	149	Time (hours per year)		600	
Cost (% of income per capita)	83.7	Total tax rate (% of profit)		34.9	
Employing workers (rank)	161	Trading across borders (rank)		126	
Difficulty of hiring index (0-100)	44	Documents to export (number)		12	
Rigidity of hours index (0-100)	60	Time to export (days)		20	
Difficulty of firing index (0-100)	50	Cost to export (US\$ per container)		1,090	
Rigidity of employment index (0-100)	51	Documents to import (number)		11	
Nonwage labor cost (% of salary)	12	Time to import (days)		41	
Firing cost (weeks of salary)	135	Cost to import (US\$ per container)		1,090	
Registering property (rank)	84	Enforcing contracts (rank)		96	
Procedures (number)	10	Procedures (number)		41	
Time (days)	20	Time (days)		498	
Cost (% of property value)	3.9	Cost (% of claim)		15.3	
Getting credit (rank)	65	Closing a business (rank)		134	
Strength of legal rights index (0-10)	3	Time (years)		8.0	
Depth of credit information index (0-6)	5	Cost (% of estate)		18	
Public registry coverage (% of adults)	15.2	Recovery rate (cents on the dollar)		12.7	
Private bureau coverage (% of adults)	43.7				

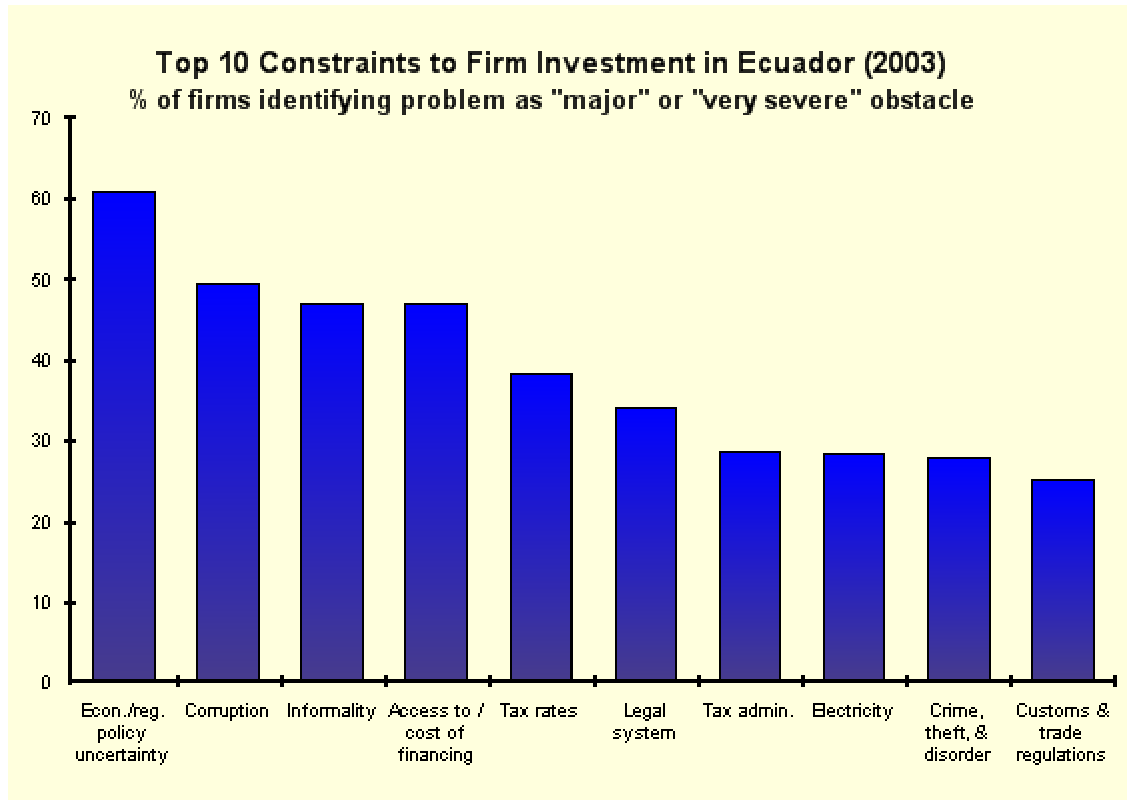
Global Competitiveness Index 2006 and 2005 comparisons ⁴			
	GCI	GCI	Changes
Country / Economy	2006 Rank	2005 Rank	2005-2006
Ecuador	90	87	- 3

³ Source: http://www.transparency.org/news_room/in_focus/cpi_2006/cpi_table (This methodology scores countries on a scale from zero to ten, with zero indicating high levels of perceived corruption and ten indicating low levels of perceived corruption.)

⁴ Total number of countries ranked: 125. Source: World Economic Forum, http://www.weforum.org/en/fp/gcr_2006-07_highlights/index.htm

An additional useful datasheet is the table of the **World Bank's "Enterprise Surveys"**⁵, in which firms are asked to identify what they perceive to be the major problems related to the investment climate.

Interestingly, issues related to economic / regulatory uncertainty are regarded by over 60% of the surveyed firms operating in Ecuador as a major or very severe obstacle to companies' investment.



The reliability and availability of infrastructure services is crucial for development and is measured by associated costs and by the use of the Internet for communication as a measure of availability of more advanced services. The data for Ecuador looks as follows (unfortunately no earlier data than 2003 is available):

⁵ Enterprise surveys measure business perceptions of the investment climate, and can be used to analyze the link to job creation and productivity growth. See <http://www.enterprisesurveys.org/>

Infrastructure	Ecuador	Region
Delay in obtaining an electrical connection (days)	29.54	26.49
Number of electrical outages (days)	9.47	14.91
Value lost due to electrical outages (% of sales)	5.04	3.26
Number of water supply failures (days)	4.12	9.06
Delay in obtaining a mainline telephone connection (days)	92.65	37.47
Firms using the Web in interaction with clients/suppliers (%)	55.41	42.8

Time spent waiting for imports and exports to be released by officials can be costly for firms and deter them from engaging in foreign trade. The data for Ecuador looks as follows (again, no earlier data than 2003 is available):

Trade	Ecuador	Region
Average time to clear direct exports through customs (days)	5.94	4.79
Longest time to clear direct exports through customs (days)	9.37	9.16
Average time to claim imports from customs (days)	15.74	7.22
Longest time to claim imports from customs (days)	28.66	14.72
Firms that export directly (%)	88.98	26.92

ASKING ECUADORIANS' OPINION ⁶

- Only 14% of Ecuador's population regards the country's economic situation as good or very good (Latin American average: 18%)
- Only 18% of Ecuador's population thinks that the economic situation at the end of 2006 is better than the previous year (Latin American average: 31%)
- 22% of Ecuador's population believes that over the next twelve months the country's economic situation will improve (Latin American average: 39%)
- Most important problem in the country
 - joblessness / unemployment (24%)
 - political situation / problems (20%)

Data from another survey on the question of Ecuador's most important problems:⁷

⁶ Source: Latinobarómetro survey conducted in December 2006. See http://www.latinobarometro.org/uploads/media/Latinobar_metro_Report_2006_01.pdf

- unemployment: 28%
 - corruption: 26%
 - the economy: 21%
 - political instability: 11%
- 47% of Ecuador's population agrees with the following statement, in relation to the question of unemployment: "The state has inadequate economic policies" (Latin American average: 44%)
 - Expectations of social mobility: 60% agree with the statement that a person who is born poor can become rich (Latin American average: 58%)
 - Who has to create wealth: the state or private enterprises? On a scale of 0 (the state has to produce wealth) to 10 (private enterprises have to produce wealth), Ecuador scores a 4.3 (average Latin American score is 4.6)
 - Is Ecuador governed for the good of all? Only 11% of Ecuadorians believe so... (this is by far the lowest score for Latin America, whose average is already low, at 26%)
 - The government seeks people's welfare: 42% of Ecuadorians agree with that statement (Latin American average: 58%)

ADVOCACY WORK: "ECUADOR CANNOT AFFORD TO WASTE ANY MORE TIME"

The Alliance has successfully advocated for the concept of inclusive business, i.e., sustainable business opportunities that are good business and benefit low-income communities, in President Correa's new social development agenda.

The Alliance's engagement of the new government of Rafael Correa (elected in late 2006 and President since mid-January 2007) has created an opportunity to integrate inclusive business as a core pillar of the new government's efforts to address socio-economic challenges.

Following several consultations with the Alliance on the vision and a presentation on their work program in Ecuador, President Correa has publicly declared his willingness to make the concept of economic inclusion an integral part of the social development agenda for 2007, with a view to overcoming the country's high level of inequality and poverty.⁸

The plan includes:

- economic inclusion, which links social needs to the creation of jobs and the improvement of income as mechanisms to reduce poverty. In this context, the government will most notably promote inclusive business opportunities in the agricultural sector (such as the ones pursued by the WBCSD-SNV Alliance in the country's cocoa and maize sector) via credit lines, as well as financing for technical assistance and infrastructure measures.
- building capacity to provide to basic and good quality services in the domains of education, health, and housing

Overall, the government's declared aim is to create some 300'000 new jobs over the next four years.

⁷ Source: Consorcio Iberoamericano de Empresas de Investigación de Mercados y Asesoramiento, CIMA, survey conducted in March 2006, available online at <http://www.cimaiberoamerica.com/pais.php?pais=ecu>

⁸ Source: Ecuadorian Presidency website, at <http://www.presidencia.gov.ec/noticias.asp?noid=8785>

Furthermore, the Alliance will pursue additional advocacy avenues, most notably:

- Advocate for the creation of a public fund for the promotion of inclusive business covering some of the marginal costs emerging when a private company engages with small, low-income producers. This public incentive would help companies make the first step towards small producers. In the current system they have no incentive and face a high risk working with small producers if they already have a relatively reliable and competitive supply of goods.
- Develop lines of credit channeled via the national finance system for low-income companies and families. This could most notably lead to more investments by small producers already involved within one of the inclusive business models being developed by the Alliance. Another option in this context could be to follow the Chilean example, where the government delivers an incentive voucher for each credit rolled out by financial institutions for small, low-income producers.
- Advocate to the government to promote subsidy schemes that would allow low-income communities to get access to low-cost housing (in close collaboration with the Inter-American Development Bank, Andean Development Corporation (CAF), World Bank, etc.)
- Amend the legal framework so as to allow the use of mixed biofuels with fossil fuels
- Promote agricultural insurance backed by a government subsidy scheme

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