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Ecuador: crisis and adjustment policies. Their effect on agriculture

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In the 1970s the production and export of oil caused enormous economic and social changes in Ecuador. The gross domestic product grew at rates of between 14 and 25%, and there were considerable increases in the formation of capital, in demand—especially in the public sector—and in imports. The first signs of a balance-of-payments problem appeared in 1975 and they reappeared with force in 1977, reaching two years later levels of external debt whose service took 65% of export earnings.

Agriculture underwent important changes in its production structure in that decade. There were sharp declines in output in the Sierra for domestic consumption and in traditional exports; rice production increased on the Coast; and the most significant change was in livestock, with a doubling of the area of grazing land.

The rise in the international interest rate at the beginning of the 1980s caused a large deficit in the balance of payments which was financed by further borrowing and depletion of international reserves. The first adjustment measures were devaluation and restriction of imports. The situation turned critical in 1983, the year of the catastrophic floods which caused a sharp drop in farm output. A new series of economic measures included devaluations and minidevaluations, higher interest rates and control of public spending. With the change of government in 1984, priority shifted to adjustment of the exchange rate and management of interest rates, while State controls and intervention were reduced.

The trends in agriculture were unclear between 1980 and 1985. Nevertheless, there was a definite recovery of the area under basic crops as a result of the policies introduced for that purpose, including in particular the credit policy. Industrial crops, in contrast, made only a moderate recovery, while export crops achieved a large increase as the result of the various incentives introduced. Livestock production increased at high rates but without any improvement in its average productivity levels.

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I

The 1970s: the oil shock

1. The effects on the product and other economic variables

The feature of the 1970s, which began with a period of sluggish exports—especially of bananas—and balance-of-payments problems, was the start of oil production in Eastern Ecuador and of oil exports. After the economic downturn which lasted until 1971, oil exports triggered a real explosion of economic activity: exports comfortably increased fivefold between 1970 and 1975, while the gross domestic product rose 14% in 1972 and over 25% in 1973. The expansion of public spending and the formation of capital, especially of public origin, transmitted to the economy the vigorous stimulus of the increased exports, causing a rapid rise in imports. In any event, the fierce acceleration of the growth rate was a phenomenon limited to the period 1972-1974; the rest of the decade was characterized more by accommodation or by delayed effects, but the repercussions of the second oil price rise still had a powerful impact towards the end of the decade. For the purposes of this analysis it is of particular interest to observe the influence of this rapid growth on the economy's internal and external stability.

The legacy of this period, which began paradoxically with an abundance of external resources, was an acute disequilibrium in the balance of payments. This did not originate in the expansion of imports—although they grew at almost the same rate as exports—for international reserves increased throughout the decade except in 1975; nor can it be said that there was a shortage of external resources. The disequilibrium stemmed from the increased service of the foreign debt which began to make itself felt in 1976-1978. The debt began to increase in about 1977 and by 1979 it was already very large; in 1979 the service amounted to 65% of export earnings.

The origins of the debt must be sought principally in public finances. From 1975, after the boom of the previous two years, the public deficit grew rapidly and was financed with external

resources, causing steady expansion of the debt. By the end of the decade the economy was suffering from a shortage of domestic saving and external resources which was steadily growing worse.

The expansion caused by the oil exports also had an impact on the behaviour of the consumer price index, which achieved a growth rate of 23% in 1974, unprecedented since the index began to be recorded. Up till then Ecuador's economy had been characterized by prudent monetary management and low inflation. The stagnation of exports and the fiscal deficit which it experienced towards the end of the 1960s and in the early 1970s increased the inflation rate, which reached almost 10% in 1971 (partly as a result of the 1970 devaluation). The surge of oil exports in 1972 initially dampened the inflationary pressures, but they later came back strongly as a result of the remarkable inflow of foreign exchange. Demand pressures pushed inflation up to 23% in 1974, as already pointed out. The adoption of a policy designed to neutralize the effects of the exports boom, especially by means of restriction of internal credit, helped to reduce the inflation rate but it has remained in two figures since that time. The "foods and beverages" item in the consumer price index seems to have played a leading part in the intensification of inflationary pressures.

It was logical that a period of such rapid growth as the one described above should produce profound changes in the structure of the product by sector of activity. The growth rate of manufacturing industry between 1970 and 1975, which was 14% as an annual average, contrasted sharply with that of agriculture, which remained at the same 2.8% a year of the 1960s. Operations in the mining and petroleum sector naturally achieved a remarkable growth rate, and the construction and services sectors (trade, transport, public administration, etc.) recorded rates slightly below that of the total gross domestic product (9.4%). The importance of these developments can be appreciated from an analysis of the distribution of the economically active population (EAP) between the census years of 1974 and 1982. Industry created jobs for a large number of persons (59 000) in the period, while the agricultural EAP fell in absolute as well as relative terms, which was a symptom of the

sector's lack of vigour in a period of strong growth in demand. It employed 47% of the EAP in 1974 but only 33.7% in 1982, reflecting a massive rural exodus which occurred in this period.

Services increased their share of the EAP from 36 to 50%, with almost zero growth of the product per person employed, an indication that these sectors were expanding on the basis of underemployment. In agriculture too the product per person employed showed little increase; in industry, however, it recorded a considerable rise.

The trends in oil exports were described earlier; their share in total exports was so great that it is easy to forget what happened to other exports. Apart from their enormous overall increase (from US\$190 million in 1970 to US\$2 140 million in 1979) exports underwent considerable diversification not only as a result of the oil boom but also because of the increased exports of processed cocoa and coffee products and of fisheries and fish-farming products, and traditional farm exports also increased fairly regularly.

These years really saw the beginning of the export of manufactured goods, some of them relatively complex (such as articles of the so-called white line), one of the main markets for which was the Andean Group which had come into being in 1970. However, for various reasons a large part of this diversification proved unstable (processed cocoa products, goods for the Andean Group, etc.), and therefore decisive importance was retained by traditional exports, in the markets for which, despite the relative stability of those years, conditions persisted which made them too potentially unstable. In any event, this was a relatively favourable period for Ecuador's traditional exports.

Imports also increased rapidly from 1970 to 1979, but at a somewhat slower rate than exports (22 and 30% a year respectively). This growth was due in part to the effort to reduce the cost of imports of capital and intermediate goods and certain consumer goods in order to check inflation and stimulate industrialization. External purchases of these items increased in absolute and relative terms but risked making the balance of payments less flexible; industry showed a strong increase in its dependence on imported inputs, which were very difficult to substitute.

Imports of agricultural products comfortably tripled in the period (1978-1979 average against 1970-1971 average), although they fell in relative terms, indicating a shift in demand, especially in the case of foodstuffs, towards products which were in short supply in the country and also difficult to substitute; this also increased the vulnerability of the balance of payments.

A period of such rapid income growth should have had visible effects on the social structure, although this was not an explicit goal of the policy actions. The structures of privilege and inequality certainly remained in place, but major changes did occur and they must be emphasized. As a result of the slow implementation of measures introduced in earlier years, such as the agrarian reform laws, and as a consequence of the "modernization" of the economy, which increased sharply in the 1970s, there was an increase in the numbers of people in the middle levels of income distribution in both urban and rural areas. The agrarian reform made a contribution to this development in rural areas, for apart from the undesirable consequence of a larger number of small farms, it produced a situation in which medium-sized farming units (10 to 100 hectares) became the dominant operation in Ecuador's countryside. In urban areas the rapid growth of jobs in activities of relatively high productivity such as industry, construction and some services lifted a large part of the population to the intermediate levels of income distribution. The social groups at the extremes of the income scale ended the decade with even more pronounced differences in living standards than before. The situation of the deprived did not improve and very probably worsened, although at least their relative weight in the urban economy did not increase. Something similar may have happened in the countryside among owners of smallholdings of under one hectare and landless workers, although their numbers were reduced by the rural exodus.

2. *The macroeconomic policies and their results*

According to Chhiber and Wilton, macroeconomic policies are "policies which play a predominant role in determining the intersectoral

allocation of resources".¹ In this sense, the exchange-rate policy, with fixed rates and increasing undervaluation of the rate throughout the period, was probably the most influential factor in creating a bias in the allocation of resources. This policy discriminated against the expansion and diversification of exports and substitution of imports, although in the latter case its impact was offset to an undetermined but large extent by the combination of tariff policies and the benefits of development legislation.

In the case of non-traditional exports as well (both manufactures and farm products) some compensation was provided by the *Certificado de Abono Tributario* (CAT) (Tax Payment Certificate), although it was insufficient, especially in the case of farm products, owing to the undervaluation of the exchange rate. In both cases, exports were subsidized by this certificate but it provided a larger subsidy for industrial goods, which also enjoyed tax incentives under the development legislation. The traditional export products (coffee, cocoa, and bananas) suffered the greatest adverse discrimination: they did not receive the CAT and, moreover, coffee and cocoa were subject to export taxes. The discrimination against these products was clear, but this did not prevent export operations from being often profitable.

The effective total protection of imports substitution products was very high, and the output of the food industry was also protected. According to the studies by Parot,² several sub-programmes of the food industry were among the industries which he classifies as "protected" or "superprotected", but there are others which he considers "doubtful" in this sense, such as milling, which made increasing use of an imported raw material (wheat) in the prior licensing system. In these and other cases (barley for the brewing industry, oats) the shortages which seem to have existed and which hurt

¹Ajay Chhiber and John Wilton, "Macroeconomic policies and agricultural performance in developing countries", *Finance and Development*, vol. 23, No. 3, International Monetary Fund and World Bank, September 1986, p. 6.

²Rodrigo Parot, *Elementos técnicos para una estructuración de incentivos industriales*, Centre for Latin American Development Studies (CLADS), XV, vol. 1. *Estructura de Incentivos Industriales de Ecuador*, 1981, February 1985 (photocopy).

primary production may have been due to a mistaken prices and imports policy.

The effects of the other macroeconomic policies —interest rate, credit, prices and wages— varied from case to case; the prices policy seems on the whole to have favoured agricultural production, by commission or omission, except in the case of wheat, barley and milk. The policy of low and negative rates pursued almost throughout the decade benefitted capital-intensive activities most of all and therefore industry and certain forms of farm modernization, some of which may have been inconvenient. Lastly, the policy of lower and less controlled farm wages did not encourage the sector's development either and certainly helped to speed up the rural exodus.

3. Trends in agricultural production 1970-1979

In view of what has been said in previous sections, it is worth emphasizing certain features of agricultural production in the 1970s.

- a) The production of goods for domestic consumption and of traditional export goods rose slowly and held back the sector's overall growth. The annual growth rate of the agricultural gross domestic product in the 1970s (2.8%) was virtually the same as in the previous decade; moreover, the sector's contribution to the gross domestic product fell from 25% in 1970 to 14.3% in 1979. The rest of agricultural production performed vigorously.
- b) Agro-industry acquired decisive importance in exports diversification. However, its expansion increased the dependence on external supplies as its demand for raw materials contributed to the rapid growth of imports.
- c) The substitution of imports of agro-industrial goods, which advanced strongly in the decade, seems to have reached a standstill. There was thus a slowdown in the growth rate of external purchases of non-food raw materials and a halt to the increase of the domestic output of farm raw materials.

- d) Livestock production and the production and export of forestry and fisheries products, for which there is a vigorous demand, recorded rapid growth.

As can be seen, the relative importance of crops for domestic consumption declined and there was a considerable increase in the importance of livestock production.

There was thus an enormous cutback in the area sown with temperate crops for domestic consumption (soft maize, wheat, barley, potatoes) and in their output, except in the case of potatoes which showed a slight increase. These crops, together with rice, are the main items in the diet of low- and middle-income groups. Per hectare yields remained unchanged, except for wheat which showed a slight increase in the last years of the 1970s, soft maize which fell slightly, and barley and especially rice, yields of which increased.

With respect to the sharp rise in rice yields, according to data of the Inter-American Development Bank,³ 53% of the area was sown with high-yield varieties. This was the most noticeable effect of the green revolution in Ecuador.

On the other hand, the area under traditional export crops such as cocoa and bananas declined; although the contraction was large in the case of bananas, it seems to have been offset by the introduction of newer varieties with higher yields. Coffee and cocoa yields remained unchanged, although coffee showed a slight increase in its area sown.

This situation contrasts with that of other items of farm production which experienced strong growth. This was true of hard maize, soybeans and animal feeds. Output of the first two items showed the greatest growth between 1970 and 1979: output of hard maize rose from 102 000 to 182 000 metric tons, and soybeans from 600 to 30 000 metric tons. The area under feed crops doubled (208%) and continued to expand at a fast rate up to 1985 when it stood at 4.5 million hectares. This expansion took place mainly on the Coast and in the East, but also in the Sierra, as a result of the increased production of milk and meat.

³Inter-American Development Bank, *Economic and social progress in Latin America. 1986 Report*. Washington, D.C., IDB, 1986, pp. 110-111.

The rapid growth of these items indicated a change in the production structure, with the emphasis now on production of livestock and poultry and the feeds required in these activities. The decade's strongest growth was in poultry production, which achieved annual averages of 18.1% for birds, 17.6% for meat, and 13% for eggs. The annual average output of beef and milk was slightly lower at 7.8% and 2.08% respectively.

The apparent consumption of grains clearly fell slightly in 1974-1980, while the demand for meat, eggs, milk, fish and shellfish increased in the same period. But this increased demand was not the only cause of the shift in production; the increase in the number of small farms and the predominance of medium-sized properties contributed to the reduction of the area under wheat and barley and their replacement by other crops, many of which must have been subsistence crops and do not even appear in the statistics. The State's prices and subsidies policy also made a contribution, especially in the case of wheat. This latter factor may have been the most important, for although the price policy was generally favourable to foodstuff production, there were instances of discrimination, such as the low prices for some products (wheat, maize, rice), the very profound changes in farmers' prices and costs, as well as large regional price differences and erratic price movements. It is also useful to examine the influence of public finances and development credit on the progress of the agricultural sector in the decade in question. The increased resources resulting from oil exports eased the pressure on agriculture as a supplier of foreign exchange and source of State revenue. Thus exports, which furnished 15.6% of total State revenue in 1973, saw their contribution fall to 5.5% in 1977. The taxes on farm exports also had their relative importance in tax revenue fall from 13.5% in 1965 to 8.6% on average in 1975-1977. At the end of the decade the only export taxes still in force were on coffee and cocoa, and the sector's contribution to tax revenue was somewhat lower than that of other economic activities.

On the other hand, State expenditure clearly favoured the farming sector, but as most of the resources went to cover bureaucratic costs, the effectiveness of the results must be questioned.

Between 1970 and 1978 the number of civil servants working in public services in agriculture increased by 112.5%.

Development credit, another factor favourable to farming, was channelled through the National Development Bank. It grew 3.5 times in real terms between 1973 and 1974; it remained at a high level until 1976; in 1977-1983 it fell, and from 1984 to 1986 it stood at the average values of the 1970s.

The main period of credit expansion was 1973 to 1976 and it was concentrated on certain items which were virtually the key to this expansion. The crops which seemed to receive clear priority were rice and hard maize, especially in 1976, and cotton, especially in 1975. Lending for animal feeds and livestock showed a more moderate increase but still a sizeable one in terms of the amount involved, rising from 454 million sucres in 1972 to 1 104 million in 1975.

The increase in these three crops between 1972 and 1973 was several times greater than the amounts of credit granted previously. When lending for feeds and livestock is included, a close relationship can be seen between the loans granted and the increase in area and output.

Between 1972 and 1976 there was a sizeable increase in lending for almost all home-consumption products, followed by a widespread drop, a trend not reversed until 1984 and 1985.

With respect to the recipients of the loans, the access of small producers improved but overall the big land-holders remained the main beneficiaries. According to Commander and Peek,⁴ only 4.5% of the families of farmers with five hectares of land or less had access to credit. These data presumably refer to the Sierra, but the situation was perhaps somewhat better for the small farmer in the country at large, as can be seen from the development of rice co-operatives, which had privileged access to credit. The importance attached to the small farmer led to the establishment of the Fund for the Development of Rural Areas and Marginal Sectors (FODERUMA), which makes small loans and furnishes technical assistance.

⁴Commander and Peek, "Exportaciones petroleras, reforma agraria y el proceso laboral rural: la Sierra ecuatoriana en los años setenta", in Central Bank of Ecuador, *Revista*, No. 37, July 1986, p. 11.

The fact that the National Development Bank is governed by banking criteria explains why it should have given priority to the "most capitalized" peasants, but in any event this is not inconsistent with the purpose of public expenditure and development credit, which is to favour the most needy sector. Economic policy from 1973 to 1976 was clearly biased against the agri-

cultural sector and it discriminated in particular against the peasant and the small producer, but development credit seems to have been something of an exception. However, for all these ambiguities, an overall assessment shows that despite the obstacles and setbacks, these were the years of greatest transformation of Ecuador's agricultural structure.

II

The 1980s: financial crisis and adjustment policies

1. *Growth trends and problems*

After the runaway increase in the service of the foreign debt in 1979, financial pressures built up rapidly to a climax in 1982 and 1983. There was a large drop in international reserves in 1981, with a flight of capital in anticipation of a devaluation. The credit supply fell to US\$360 million in 1982 and available international reserves fell to a level barely above the equivalent of one month's exports.

The adjustment policies then began to take real effect and they included a devaluation, the first since 1970. These policies, which are considered below, had a dire effect on imports in 1983, for they fell 35%. That year marked the most serious point of the crisis, for apart from the impact of the restrictive adjustment measures, the country was hit by serious floods in late 1982 and in 1983. In any event, in 1981 and 1982 more than 70% of export earnings had to go on debt service; in 1982 this figure amounted to virtually half the country's gross domestic product in that year. This situation had a profound effect on the whole national economy and especially on public sector finances, which were what had caused the debt in the first place. While credit was available from 1979 to 1982 the public sector managed with apparent ease to meet its deficits. In 1982 the contribution of external financing, which was already very low, fell below that of internal financing. External financing was negative from 1983, so that the authorities were compelled to generate a surplus in the public sector by

recourse to measures which boosted current revenue (ranging from increases in gasoline prices to higher taxes on commercial transactions) and produced an abrupt cut in expenditure.

The situation in 1983 was exacerbated even further by the floods. The transport infrastructure was seriously affected on the Coast and the crop losses caused widespread shortages. This was in addition to other serious damage, and the total losses were estimated at US\$640 million. This was the main cause of the drop in the gross domestic product in 1983 and the sharp increase in the inflation rate.

For this reason and also because of the financial pressures, the total gross domestic product fell 2.8% in 1983 to the lowest point in the downward trajectory which had begun in 1981. Increased consumption sustained the economy in 1980, but in 1981 the deterioration set in with the drop in investment. The trend worsened in 1982 and was accompanied by the balance-of-payments problems and loss of reserves described above. No macroeconomic variable recorded an increase in 1983, and the serious drop in the gross domestic product represented a decline of 5.6% in the per capita product.

The years 1984 and 1985 were difficult times of adjustment and slow recovery. The 4% growth in gross domestic product in 1984 was due to the expansion of exports. The adjustment policies were less stringent in 1985; public investment and consumption rose and the gross

domestic product grew 3.8%. The 1986 and 1987 results must have reflected the effects of the fall in oil prices in 1986 and the suspension of oil exports following the 1987 earthquake. This latter year saw a further drop in the gross domestic product, and a generally difficult situation prevailed.

2. *The adjustment policies*

In 1980 the short-term policies were aimed at stabilization and not adjustment, with a view to easing the inflationary pressures generated by the increased consumption. Emphasis was given to the fiscal issue in 1981 and an attempt was made to get to grips with the problem of the growing fiscal deficit (by raising gasoline prices, for example). But the adjustment policies really began in 1982 following the worsening of the balance-of-payments problems caused by the foreign debt. Although the rescheduling of the debt clearly influenced the adjustment policies, it is not thought necessary to describe it in detail. The private external debt was renegotiated six times between 1982 and December 1984; the public external debt with commercial banks was renegotiated three times between 1983 and 1985, and in September 1983 the arrangement for refinancing of the debt with official lenders was agreed with the Club of Paris.

Three stages should be distinguished in the adjustment period. In the first (1982 to early 1983) the measures adopted were not subject to external conditions. In the second stage (1983 to August 1984) the International Monetary Fund began to have a decisive influence in the negotiations. In the third stage, from September 1984 up to the present, the policy has been based on neoliberal thinking.

a) *The 1982 adjustment*

In the first month of the year the basic aim of the measures was to adjust the interest and exchange rates. In January the legal interest rate rose from 12 to 15% and the rate for savings from 8 to 12%. The exchange-rate system was altered in March and two markets were created:

the free (of intervention) market of the Central Bank with an exchange rate of 30 sucres to the dollar and resources provided from private exports; and the official market with 25 sucres to the dollar and resources provided by oil. Both markets operated with a list of exchange rates for the determination of priorities.

The continued worsening of the balance of payments forced a second devaluation in May. Then the new exchange rate was 33 sucres to the dollar for all goods transactions and for most services transactions in the official market. In the free market the dollar was fixed at 35 sucres and despite the devaluation of 32%, the real exchange rate of 38.10 sucres calculated by the Central Bank at that time was not reached.

A number of steps were taken in continuation of the policy of discouraging exports; for example: prohibition of imports of luxury goods and restriction of purchases of other goods such as vehicles, for the import of which swap agreements were required for Ecuadorian exports. In order to make imports more expensive and difficult, they had to be paid for with loans, and a system of advance deposits proportional to the amount of the loan was introduced, together with changes in the lists of imports. Imports on List II were banned in November and imports of capital and transport goods were suspended for more than a year. These restrictions and the weakening of demand were the reasons for the drop in imports in 1983.

Exports were stimulated at the same time. In addition to the Tax Payment Certificate (CAT), they were encouraged by the devaluations and the swap mechanism, the establishment of minimum domestic prices for export goods in order to benefit producers, and the greater credit facilities and the amounts of the loans.

Credit was also used to maintain the level of activity. With this in view, a fund (of 2 000 million sucres) was established for exports promotion, together with a Value Regulation Fund for private investment, with long-term credit; the Central Bank's system of financial funds was simplified into separate funds (agricultural, small industry and handicrafts, tourism, fisheries, etc.), and a special fund was established for construction.

In order to control inflation, lending by the Central Bank was restricted and the banking reserves requirement was raised by 1% to 23%; and open-market operations were stepped up, improving the profitability of the Stabilization Bonds. However, inflation reached 24.4% in 1982 under the impact of the devaluation, the second gasoline price rise, and the higher wheat prices resulting from suspension of the imports subsidy.

These last two measures were also among the economic policy tools used to reduce the fiscal deficit, one of the priority goals. The attainment of this goal was also facilitated by the revaluation of the currency and the considerable increase in the State's share in petroleum sales. As a result of the policy carried out in 1982, the public sector deficit fell to below the 1981 and 1980 levels (although the State budget deficit persisted in real terms).

b) *The adjustment between 1983 and August 1984*

Three measures constituted the cornerstone of the adjustment policy carried out in this period: the devaluation and the adoption of the system of programmed minidevaluations; the higher interest rates; and the Law on Economic Regulation and Control of Public Expenditure.

A further devaluation could not be postponed, for inflation reached 52.2% in 1983 (December-to-December average); the exchange rate was set at 42 sucres to the dollar, with minidevaluations of 0.04 centavos per working day. The devaluation was 27%, but it did not reach the real value, which the Central Bank studies estimated at roughly 50 sucres to the dollar; the minidevaluations were intended to prevent the slippage growing any longer.

The keynote of these measures was flexibility. The shift was made from a fixed exchange-rate system to one of minidevaluations, and a dual foreign-exchange market was introduced, together with various lists of rates. In June 1983 the minidevaluations were fixed at 0.05 centavos per calendar day; in February 1984 the lists of exchange rates assigned to the two markets were altered in order to favour non-oil exports and make some imports more expensive.

Higher interest rates, another pillar of the adjustment policy in this second stage, were introduced in conjunction with the system of minidevaluations in order to prevent speculation. The goal was to prevent the flight of capital rather than to stimulate national saving. The increases came into effect in March and September 1983 and June 1984; the maximum level reached by the commercial rate was 21% in 1984, below the inflation rate of 25% in that year.

The Law on Economic Regulation and Control of Public Expenditure of March 1983 was part of the policy of fiscal austerity and increased revenue. This law extended the functions of the Central Bank and the Office of the Superintendent of Banks; some items of public spending were reduced or suspended (on furniture, vehicles, transport, etc.) and the pay rises of public employees were suspended; tariff surcharges ranging from 5 to 15% were re-established; fuel prices which had not been adjusted in 1982 were raised (diesel oil, fuel oil and kerosene). With the creation of the National Emergency Fund in June 1983, all tariff exemptions were cut by 35%; this reduced for the first time some of the incentives available under the development legislation.

These measures had the result of eliminating the public sector deficit for the first time since 1974, despite the expenditure caused by the floods; the surplus of 2 408 million sucres almost covered the negative external financing of 2 993 million sucres; and although the State budget deficit persisted it was considerably reduced.

The serious imbalance in the balance of payments called for new import controls; in March 1983 some items were transferred from List I-b to List II; imports of other goods were suspended and the many prohibitions remained in force. When the situation improved in February 1984, the suspensions or prohibitions were lifted from 75% of the imports which had previously been subject to this kind of control.

Many measures were also introduced to stimulate exports and economic activity. In September 1983 10% of the foreign-currency earnings of traditional exports was transferred to the free market (except for petroleum); in March that year non-traditional exports were given access to financing through Development

Bonds; in May the Central Bank opened a line of credit for fisheries; and in August comprehensive export permits were introduced to facilitate foreign sales of perishable goods such as flowers and fruit.

Selective action was also taken to encourage economic activity and help businesses affected by the crisis. As already stated, the development bonds arrangement was extended; the Rural Electrification Fund was established in April 1983; the National Emergency Fund and the Irrigation and Drainage Fund were established in June; and that same month saw the promulgation of the Law on Agricultural Roads Development and Manpower Promotion, in the implementation of which use was made of part of the funds accruing from the increase in oil earnings; in June a special line of financing was opened for the Sistema Mutualista (Mutual Aid System); in September the Central Bank was authorized to discount or rediscount the loans of financial bodies which were in difficulties; and 1984 saw the establishment of the Business Capitalization Fund (February) and the Forestation and Reforestation Fund (August).

Lending by the National Development Bank increased by 30% between 1982 and 1983 and lending for food crops rose by 45%.

c) The adjustment from September 1984 to 1986

The change of government brought a gradual redirection of policy towards changes of a neoliberal kind. The adjustment policy gave first priority to the exchange system and to management of the interest rate as a means of overcoming the savings deficit in support of the exchange policy. Furthermore, clear preference was given to market mechanisms and the goal of reducing direct and selective controls in the management of the economy.

Within the system of priorities of the adjustment policy, attention was also given to public finances, including the implementation of new development programmes and the control of inflation.

The debt was rescheduled in December 1985, but the fall in the price of oil in 1986 and the suspension of oil exports in 1987 as a result of the pipeline damage caused by the earthquake made a further rescheduling necessary.

The measures relating to the exchange system were introduced when the new government took over in September 1984. The system of minidevaluations was abolished and an exchange rate of 95 sucres to the dollar was established for the free market of the Central Bank to which all transactions were assigned, except for oil exports and imports on the Special List, for which the exchange rate was 66.50 sucres to the dollar. With respect to imports, the liberalization process was completed with the removal of the suspensions or prohibitions on the remaining 25% of the goods subject to these control measures.

A series of transfers to the free market of the Central Bank was started in March 1985 in an effort to unify the exchange rate at a much higher level; almost all transactions had been transferred by November that year. The formal devaluation of the exchange rate took place shortly afterwards. The average exchange rate for exports rose (32%) from 68.29 to 89.62 sucres to the dollar and for imports (29%) from 62.79 to 93.51 sucres to the dollar. The average exchange rate was thus brought roughly into line with the real rate. The dollar stood at about 123 sucres in the free market, with an upward trend.

This unification of the markets seems to have been carried out solely to achieve a further devaluation of the currency. The dual market system was restored in January 1986, with an official exchange rate maintained at 95 sucres to the dollar buying and 96.50 sucres to the dollar selling; in the free market the exchange rate was 110 sucres to the dollar.

The official exchange rate was used only for accounting purposes, for almost all exports were traded in the controlled market and importers acquired foreign currency in the free market (between 132 and 136.40 sucres to the dollar). A few exports were traded in the "private" free market (with foreign exchange provided by exports of rice and maize), where the dollar fluctuated around 160 sucres.

A number of liberalization measures were also introduced. For example, the list of producers requiring prior licences was reduced in February 1986 and permission was also given for imports of vehicles, which had been banned or subject to quotas since the 1970s. As a result of the consequent increase in imports, in March

that year the trade balance showed a deficit of US\$32 million.

The direct controls had gradually been lifted, with a view to ensuring basic regulation by means of the exchange rate. Apart from the requirement of advance deposit and the export subsidies, devaluation was the main means of tackling the balance-of-payments problem.

In view of the drop in the price of oil, a floating system was established in August 1986 for the exchange rate and interest rates; this was really what had been intended from the beginning. A dual market system was established: one for private transactions called free or private because shifts in the exchange rate were determined by the law of supply and demand; and an official market to underpin State expenditure with foreign exchange provided by oil exports. When this measure was adopted, the dollar fell to 140 sucres in the free market, entailing a sizeable devaluation for exports (27 to 30%). The official exchange rate followed the floating rate, so that in practice a single exchange rate was established. The rate rose after March 1987, moving above 160 sucres to the dollar in April.

The aim was to stimulate exports by removing discriminatory measures and speeding up procedures. The reduction of the protection of domestic production was evident, and this was quite inconsistent with the typical neoliberal models.

As already pointed out, interest rates were another essential factor in the adjustment policy. Commercial interest rates rose from 21 to 23% in December 1984; the interest rates for savings rose to 20%; and the rate for financial paper to 25%. The "special" Accumulation Vouchers were introduced at the same time, with a minimum amount of one million sucres, a term of at least 90 days and floating interest rates tied to the market; these rates varied from 24 to 36 or 37%. By the end of 1985 34 000 million sucres had been taken in, i.e., a quarter of the money supply. However, the credit based on these resources was of little interest for production activities owing to its high cost.

The government's actions did not achieve such concrete results as in other areas. For example, owing to administrative omission, the control of consumer prices ceased, although it was something which the government wanted.

Furthermore, although steps had been taken to promote foreign investment, such as the abolition of most of the conditions introduced in Decision 24 of the Cartagena Agreement and the agreement with the Overseas Private Investment Corporation, the results were not satisfactory. The benefits provided under the industrial development legislation were also limited, but at the same time the government introduced other laws with similar features (handicrafts and small-scale industry, agro-industry). Nothing concrete happened with respect to privatization, except in agricultural marketing.

In contrast, although this was not among its priorities, the government had to attend to the financial consolidation of the State. With this in view, fuel prices were increased in December 1984 and March 1987; the tax on commercial transactions was raised from 6 to 10%; and a number of indirect taxes were introduced or increased.

Despite the enormous increase in current revenue and transfers (83% over 1984 in current sucres), spending under the State budget increased so much that the deficit rose by 58% over the previous year. The result seems to have been the reappearance of some of the conditions which led to the heavy borrowing of the late 1970s. In the present circumstances the acquisition of new loans would mean an even greater deterioration in the growth rate or a resurgence of inflation.

3. The main effects of the adjustment policies on the sector's development and other aspects of the economy

Tariffs —the traditional protectionist tool—remained basically unchanged during the 1982-1984 period of the adjustment; they were not altered until the end of 1986, with a slight reduction of the protection in both nominal and real terms. The effect of other instruments (devaluations and para-tariff measures in all their variety) from 1981 to 1984 increased the nominal protection but without discriminating against any particular sectors. The policy goal in this emergency period was to secure a radical shift in the ratio of internal to external prices and to cut imports sharply. When the subsequent softening of the para-tariff measures is taken into

account, the system tended to be somewhat less protected than before and more favourable to exports. It was more favourable to the agricultural sector than the resource allocation machinery of the 1970s and early 1980s. The system had a generally restrictive effect on imports in 1984, a factor which lost much of its impact from 1986 as a result of the measures and policies adopted in that year.

The crisis and the adjustment produced considerable changes in the sectoral growth trends of the past 20 or 30 years. The seriousness of the situation can be seen in the lower growth of all activities; the farming sector was among those which fared best, with an average annual growth rate of 2% in its gross domestic product between 1979 and 1985. Industry contracted for three years in succession from 1983 to 1985 and this weakness has lasted to the present; construction fell sharply in 1983 but began to recover in 1985.

The agricultural sector's growth was due first to livestock production and then to fisheries and forestry. Output of traditional exports fell in 1983 and rose slowly in the next two years. Domestic consumer goods and farm raw materials fell by a similar amount in 1983 and did not recover subsequently. The situation was certainly not favourable to these two subsectors, and the basic cause lay in the disasters of 1983.

The crisis also caused a significant retreat from the diversification achieved in Ecuador's exports in the 1970s. The total value of these exports increased at an average of 4.3% between 1979 and 1985, a rate which can be described as fairly satisfactory. But it masked the weakness of non-oil exports, which fell in comparison with 1979.

The main cause of this decline was the sharp drop in exports of industrial goods, both foods and non-foods. Most remarkable in the case of food products was the drop in foreign sales of processed cocoa products; several non-food export lines which were of special interest by virtue of being important items in trade with the Andean Group came virtually to a halt.

Accordingly, the only non-oil items to show any strength were a small group of non-traditional commodities, the most important of which were prawns, exports of which quadrupled between 1978 and 1985.

In any event, there are marked differences between the present exports structure and that

of the end of the 1970s, and exports have gloomy future prospects in view of the predominance of sales of petroleum and traditional products, which have unstable and weak markets.

Imports were one of the variables most affected by the adjustment policies. In 1983 they fell 41% with respect to 1982, and recovered slowly in 1984 and 1986. The import figures show how the adjustment affected the different activities: in the depths of the crisis there was a sharp drop in imports of capital goods for industry, transport and construction. Overseas purchases of raw materials for industry grew much more slowly than in the past and with extreme fluctuations from year to year. In agriculture the import of direct-consumption food products fell regularly from 1979 but this was the only agricultural item to behave in this way; the others (capital goods, agricultural raw materials for industry, agricultural inputs) rose steadily, except at difficult moments such as 1983. In this case farming seemed to predominate in the composition of imports as well, at the expense of other sectors such as industry. The increased proportion of farm imports, apart from reflecting greater external dependence, is an indication that this activity was less affected than others by the crisis and the adjustment.

With respect to price trends, the main measures of the adjustment policies (devaluations, higher prices for gasoline and other goods and services, higher interest rates, etc.) had an inflationary effect which was reflected in the steady rise of the consumer price index from 1980. It rose 14.8% in that year; the rate was 24.4% in 1982, and in 1983, with the shortages caused by the floods, it rose to 52.5%. Inflation was checked in the last month of that year and reduced to 25.1% in 1984; from then until 1986 it remained more or less at that level.

The faster inflation and the adjustment policies themselves caused real wages to fall from their 1980 level following the doubling of the minimum wage decreed in that year. According to an approximate calculation based on the minimum wages, it is estimated that real wages in 1986 were equal to 77.5% of their 1980 level.

Unfortunately there is little information about the effects on employment and income distribution. The signs point to a profound deterioration since the last years of the 1970s. The

inequalities also seem to have worsened. According to research carried out in rural areas, the real average income of peasants was lower in 1981 than in 1970 and open unemployment increased 65%. Other estimates of open unemployment and underemployment indicate similar conclusions about this deterioration.

4. *The agricultural sector in the 1980s and the adjustment policies*

Despite the large volume of resources received by the country during the oil boom, the rural sector still has difficulties which are really a reflection of structural problems in the area. First among them is the underemployment which is thought to affect more than 50% of the country's economically active population; this problem has proved impossible to alleviate.

As stated earlier, the government's spending, credit, development and other policies in the 1970s were intended to favour the sector, but the most important macroeconomic instruments, such as tariffs for example, were biased towards urban activities. A change seems to have been made in the 1980s with the aim of removing this bias and introducing a favourable pattern, especially for exports of commodities. In contrast, the situation of farm production for domestic consumption is more ambiguous, for price policies and other tools seem to favour it, while the contraction of consumer demand and other elements of the adjustment policy have affected it adversely.

The difficulties can be seen more clearly in the light of the priorities of the adjustment policy, for the aim is to encourage a "modern agriculture with medium-sized and large farms".

The agrarian reform and integrated rural development were still being implemented at the beginning of the 1980s, but in the past three years the reform has almost come to a halt and there has been a considerable reduction of activities in the rural development programme, which promotes mainly the modern sector producing for export.

a) *Situation and trends in agricultural production 1980-1985*

A summary now follows of the main features of agricultural production in the period in ques-

tion. In the farming subsector the production of traditional export crops (bananas, coffee and cocoa) underwent a transformation between 1980 and 1983, especially as a result of the floods, with its growth rate falling from 8.3 to -35.4%. The heading "other farm products", which includes products of direct domestic consumption and agro-industrial products, also fell sharply in those two years and in 1985.

Output remained stable in the livestock subsector in 1980-1985 except in 1983. The heading "hunting and fishing" recorded spectacular growth rates, owing mainly to the development of prawn farming.

The destruction caused by the floods made 1983 a completely abnormal year, and all items recorded negative growth rates.

Some 950 000 persons, or 11.8% of Ecuador's population, were directly or indirectly affected by this disaster, losing their homes, harvests, or subsistence incomes. According to CONADE,³ between 12 and 15% of the country's area was flooded. There was also a great scarcity of commodities which made itself sharply felt in supply difficulties, speculation and hoarding. Export output fell sharply and there were widespread and serious difficulties in the marketing of farm production.

With respect to trends in agricultural output, the expansion of the area under basic food crops, which reached 6.9% (equivalent to 35 000 hectares) in 1980-1985, may indicate a reversal of the general trend of 1970-1985. The small recovery brought the total area to 502 000 hectares in 1980, considerably below the 795 000 hectares of 1970. Although productivity improved, it was still lower than that of farm products for industry and export or that of other Latin American countries.

Lending by the National Development Bank for food production increased at an annual rate of 8.9% between 1979 and 1985, which was second only to lending for livestock and animal feeds production.

There is clearly greater awareness of the need to reduce the external dependence for food supplies and that one of the solutions to the international crisis is the development of the

³CONADE, *Ecuador y lineamientos para una estrategia para el desarrollo*, July 1984 (mimeograph).

agricultural sector so as to satisfy the requirements of direct consumption, industrial consumption and exports.

The increase in the area used for the production of industrial raw materials in 1980-1985, was 5 000 hectares, considerably below the increase of 15 000 hectares in the previous period.

The marked preference in agricultural policies for increased exports is the reason for the rise of 150 000 hectares in the cultivated area in 1985, especially for coffee, in contrast to increases of 30 000 hectares in 1980 and 700 hectares on average in the 1970s.

Owing to limitations in the external market or in domestic industrial use, the area for "other farm products" (figs, tea, pyrethrum, tobacco, agave and other less important items) declined by almost 10 000 hectares, in contrast to an expansion by 70 000 hectares in the previous decade.

The area under crops showed a decline in the 1970s (-64 000 hectares); in the first five years of the 1980s, however, it increased (200 000 hectares) owing mainly to export crops, especially coffee.

The increase in grazing land, which reached 83 000 hectares a year, is considerable but shows a marked decline over the increase of 230 000 hectares a year recorded in 1970-1980; this decline was due to the fact that it is becoming increasingly difficult to convert land.

The net increase in the agricultural area was 600 000 hectares between 1980 and 1985, while in the previous decade it was 2.2 million hectares. The overall area increased from 3.5 million hectares in 1970 to 5.5 million in 1980 and 6.2 million in 1985.

The amount of lending by the National Development Bank to the agricultural sector is consistent with this increase. Preference was given in this lending to animal feeds production and livestock, which increased from 742 million (1975) sucres in 1975 to 1 424 million in 1985, a growth rate of 11.5% a year and a total increase of 92%. In second place was food production, which received loans of 845 million in 1975 and 1 411 million in 1985, with a growth rate of 8.9% a year and 67% in total.

In contrast, lending by the Bank for export products fell at an annual rate of 10.3% between

1975 and 1985 as these products have access to a variety of sources of credit.

Lending for farm machinery increased from 258 million in 1979 to 436 million in 1985 in real terms, a growth rate of 9.2% a year.

In short, total lending by the Bank for agricultural activities increased from 2 400 to 3 800 million in 1975 sucres in the period 1979-1985, or in other terms, the overall increase was 60% at 8.2% a year.

Per hectare productivity performed very variably. For example, rice productivity increased in the 1970s and was maintained in the 1980s, with a downward trend, below 3 000 kilograms per hectare; in 1985 it fell 11.8% over 1980. The increase of 35.3% in the area under this crop bore no relationship to the growth in output of only 4.4% in the period.

Wheat maintained a productivity of 1 000 kilograms per hectare from 1978, while the area and the physical output continued to fall. Barley improved its yield from 600 kilograms per hectare in 1970 to 900 in the 1980s. Potatoes remained above 12 000 kg/ha between 1971 and 1976 and have been slightly over 11 000 kg/ha in the 1980s. The area under this crop increased 20.4%, its production 30.9% and its yield 8.2%, indicating that the increase came mainly from expansion of the area.

There was a noteworthy increase (32.8%) in the area under African palm both on the Coast and in the Amazon Region. The yield also improved (40.2%). Sizeable increases have also been achieved in the present decade by hard maize (54.1%) and soybeans (34.9%).

Cotton-growing depends on the rainfall pattern and market preferences. Its productivity was very variable: it was high in 1980, at 2 050 kg/ha, but it achieved barely 400 kg/ha in 1983 and 600 kg/ha in 1984.

The area under bananas varied considerably, falling from 190 000 hectares in 1970 to 70 000 in 1980 and 65 000 in 1985. Yields increased from 12 800 to 32 200 kg/ha in 1980, then fell slightly. Exports showed little change at between 1 400 and 1 600 million tons a year.

Coffee productivity was low (a little over 300 kg/ha) in several years of the 1970s and it fell in the 1980s. The area cultivated, in contrast, showed a considerable increase from 288 000 hectares in 1980 to 427 000 in 1985, and produc-

tion rose with it. The expansion of the area was 48% and of output 74%, but unit yields improved only 17%.

Cocoa productivity was generally low. There was a large increase in the area cultivated in the 1970s (to 288 000 hectares in 1978) but it then remained unchanged. However, output was unstable, with large fluctuations; it amounted to 131 000 tons in 1985, a result which improved productivity by about 35%.

Increases were recorded in beans and legumes in general between 1980 and 1985, with 15% higher productivity; the same happened in the case of vegetables.

Livestock productivity was generally low, except in some herds in the Sierra. Average milk productivity was only 4.5 litres per day per cow. However, livestock production grew strongly, as did its derivatives; nevertheless, milk production is insufficient to supply the national requirements.

It is easy to see that a boost is needed for intensive livestock-raising. Milk consumption could be replaced in part by the steadily increasing production of crops with a high protein content, such as soybeans for example, which can be grown on a large scale on the Coast and in certain Amazonian areas.

In general terms the indices show a considerable growth in livestock production in the five years 1980-1985: beef production rose 28% and milk production 38%; stocks of poultry increased 25% and production of poultry meat 20%.

The 1970s saw a change in the composition and profile of demand in favour of "superior" foods such as foods of animal origin and those which use imported raw materials, such as bread and wheat. In the present circumstances of economic recession with increasing levels of unemployment or underemployment, consumption has fallen and livestock products have become luxury items with a limited demand.

This situation is reflected in the latest calculated malnutrition indices which show that 55.6% of children aged up to 60 months suffer from chronic malnutrition, and 9.7% of children aged from six to 36 months suffer from acute malnutrition.

b) *Other specific policies for the agricultural sector: recent trends*

As already pointed out, in the period under study there was a clear shift of emphasis in agrarian policy and its programmes of agrarian reform and settlement. In the two years 1979-1980 an average of 76 000 hectares a year was legally allocated under the agrarian reform programmes, to the benefit of 12 000 families in each year. This was the period in which work in the programmes was most vigorous. Between 1981 and 1985 the average area of allotments fell to 35 000 hectares a year and the number of recipient families to 4 000. In 1985 the total area allotted was only 28 000 hectares for a little over 3 000 families. In fact, in that year and in 1986 no new cases were opened by the Ecuadorian Institute of Agrarian Reform and Settlement (IERAC); the reform is at a standstill.

In recent years, however, there has been a clear preference for settlement, especially in the East. From 1973 to 1980 the annual average area of allotment was 133 000 hectares and 3 000 families benefitted, whereas in 1981-1985 this average rose to 183 000 hectares and 4 300 families.

This preference is consistent with the government's general policy of giving definite support to "modern" farming on a large and medium scale. As a result, no attention has been given either to the integrated rural development programmes, which have recently run into financial difficulties.

There is also a marked contrast between the prices and marketing policies of the present administration and those of its predecessor at the beginning of the decade. Under the Price Control and Quality Law, in the earlier period the policy was implemented by means of control of a small group of products for which, depending on their type, support (incentive) prices of maximum consumer prices were fixed. This policy was beset with administrative difficulties and had little effect, but it did help to some extent to counter inflationary pressures, although the administration of the support prices may not have been effective enough. The number of controlled products was sharply reduced in 1985, hardly any maximum consumer prices were fixed, and the emphasis was shifted to the con-

trol of incentive prices to the producer. Nevertheless, the inadequate control of the prices of agricultural inputs and the prices effectively paid by intermediaries and purchasing industries (mills, textiles industry, etc.) undermined the incentives policy and created difficult situations for producers of some important items such as rice.

Lastly, as it is the basic element in agricultural policies, we will now consider the evolution of expenditure on agricultural development in the State budget and the amounts of lending by the National Development Bank. In recent years credit has had even more importance than before as a tool of stimulus and guidance in view of the difference between the interest rates on the Bank's loans (18%) and those prevailing for other bank loans (over 30%).

As an enormous proportion of the State budget had to be allocated to service of the foreign debt (27.4% in 1984), all other items of expenditure were cut, except education and

health. State expenditure grew even faster than in the period of the oil boom (8.2% a year in 1979-1985 as against 6.5% in 1970-1979), but this was due mainly to the need to service the debt which, however, continues to grow steadily.

State spending on agricultural development fell in both relative and absolute figures (in real terms) and this should have had a serious effect on the policy for the sector. Strictly speaking, it is not a question of choice of priorities but of the burden of an apparently inevitable general restriction.

However, this restriction did not exist in development lending, at least up to 1985. From 1983 to 1985 this lending grew rapidly and in 1985 it reached levels which, in real terms, exceeded those of 1975, the year of maximum volumes in the oil period. The allocation of this credit followed roughly the same patterns as in the past, except in the case of rice which, as in 1975, received clear preference. In contrast, cotton lost the importance it had in the past.

III

Some important changes in the structure of agricultural production in the period 1970-1985

There was a noteworthy change in the use of land during this period. The area under bananas for export and basic food crops declined, giving way to extensive livestock production, new crops for agro-industry (especially African palm oil) and agro-exports (hemp and prawns, for example).

For all basic foods, the cultivated area declined 32.5% or 258 000 hectares in absolute terms. The areas used for grains, legumes and tubers were hardest hit, yielding to farm production for industry which increased by 125% or 175 000 hectares. Grazing land underwent a spectacular expansion, in the order of 135%, with the incorporation of 2.5 million additional hectares.

As a result of the downward trend in food production, external dependence increased and food imports rose between 1968 and 1985, with their value increasing ten times from US\$11.3

million to US\$119 million in that period. The largest purchases were of sugar, grains (wheat and barley), edible oils and fats, and dairy products.

Finally, the main features of what happened in the period in question are summed up in the decline in the farming area in spite of population growth of 3.4% between 1964 and 1974 and 2.8% between 1974 and 1982; the persistently poor yields per unit of area; the small (and declining) proportion of the total farming area used for the production of basic foods, for out of 1.73 million hectares only 537 000 were used for this purpose, equal to 31% of the total; the expansion of grazing land, but with an animal per hectare/year ratio of 1.2 in 1972 and 0.84 in 1985, which reflects poor herd management; and a real per capita milk consumption of 231 cm³ a year, below the recommendation of 350 cm³ of the National Nutrition Institute.