BUSINESS FOR DEVELOPMENT:
IMPLICATIONS FOR EXPORT STRATEGY-MAKERS

ECUADOR

ROAD MAP TO SERVICES

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Bananas are Ecuador's largest private export product accounting for 18% of total exports, and 29% of non-oil exports excluded. Ecuador is the world's leading banana exporter. In our agricultural economy, banana production represents 2.5% of the GDP, and provides support to 200,000 people mostly in rural areas. Banana is a key driver in the economies of the El Oro, Guayas, Los Rios and Manabi provinces. Banana production is mostly in the hands of small farmers, and exports are managed by larger companies. The struggle between small farmer producers and exporters is a continuous fact of Ecuador's reality. A law enacted by Congress to protect farmers has forced Government officials to fix a minimum rate for the banana box. This never ending pressure to lower or increase the price follows the seasonal changes in the world market conditions. Banana farmers are poor, and recently there have been some accusations of child labor, mainly to the big banana plantations.

Within the world market, banana exports have also occupied a very visible position. In 1998 the WTO ruled the European Union's quotas to former colonies to be illegal, and forced the EU to open their market. The United States and some Latin American counties, including Ecuador, won the WTO panel. We should expect that in the coming years the fixed amounts of exports, as well as the small money flows for the fruit producers would be left to market forces.

Currently, the going price for a banana box (42 lbs.) is $2.90 in Ecuador, and in the case of smaller producers, who usually get less for their product, it goes down to $2.20. The wholesale market price for the same box in the United States is around $20.00, and the retail price of the fruit, can run up to $40. The difference of prices can be accounted for in the following way: transport costs, maturing services, selling commissions, and the point of sales costs. Therefore, we must ask ourselves where the money is really going. The big money is going to services in the value chain, while the agricultural sector is debating over a few cents. The value added by the banana producer is no more than a dollar, while all the following steps added 97% of the final price paid by the consumer.

Coffee has been also a traditional and important export product in our country. The pound of coffee is sold in international markets at $0.80. The farmer gets no more than $0.60 per pound. The current price is below the cost of picking. However, the price of a cup of coffee has been increasing effectively for the world consumer, as most of the coffee is drunk at coffee shops and restaurants. A cup of coffee at Starbucks costs up to $2,99 and contains less than $0.01 of coffee beans.

Colombia's coffee growers have marketed their product intensively in the United States and Europe, under the "Café de Colombia" brand. The brand has an important name recognition in world markets. However, the brand name still is insufficient to shield their product from low commodity prices. The Colombia coffee growers have recently announced their intention to enter into de service industry, and compete with coffee shop powerhouse Starbucks. Colombia coffee growers are recognizing that is in the service sector where it can returns to its affiliates.

These two examples try to exemplify the lack of connection between our current exports and the development of a growing service sector. The world has been growing in services, while commodity prices have dropped consistently in the last 20 years. As a result, even in our more traditional exports, we missed the train. Most of the value goes to the service sector attached to our agricultural exports, but in no means to our economy.

Ecuador based its development in the 60´s and 70´s in the import substitution model, developed by some economists in the CEPAL. The import substitution model placed a disproportionate weight on industrial development, as a means to attain country development. Under the precepts of the import substitution model, a country needed to develop a local industry. This local industry would compete with the country's imports, to such a point where eventually it would be needless to import, as everything would be produced locally eliminating all import competition. The results have been documented; local industries never attained neither the competitiveness, nor the quality to compete, mostly because of a lack of market signals. Our country partially abandoned the model in 1990´s, however the lobby of the industries which grew and survived under this model remains powerful, and well as the notion that came with it, that industry is a key element to the country's road to prosperity.

Under traditional views, the service sector has been conceived as a lesser alternative to more desirable forms of economic activity. From the agricultural economy to the industrial our society has been taught to judge economic activity by the goods delivered to the market. The evolution of the service economy is relatively new phenomenon even in first world countries. The cultural change is beginning to happen in our society, as more jobs are derived from services. We note that local universities are rapidly responding to the change, offering more diverse, service oriented careers.

Our agricultural sector is trapped in a model of low investment, low competitiveness. There are many factors contributing, and there is little light on the solution. At the same time, subsidies policy in the EU and United States towards some agricultural products creates an environment of high resistance to trade and openness. The share of agriculture in the GDP is disproportionate to a country in the road to prosperity.

Ecuador faces the pressures of two jointing forces, agricultural sector and the remains of the import substitution industries, that oppose the opening of our local market to international markets and trade. Furthermore, the current pressures insist on returning to a high tariff model. The debate around the long-term survival of various sectors is dominating the economical scene in Ecuador. In consequence, the importance of the service component of the economy has never received proper attention in the public debate.

Economies, in order to be competitive, need that all of its sectors to contribute. No individual sector in an open economy can carry the dead weight of other sector inefficiencies. In order to produce even the simpler commodity, the producer demands a variety of goods and services. Hence, the competitiveness of the service economy is as important as the any other sector. Policymakers should aim at driving that competitiveness by opening to wider competition.

The population has little understanding of the contribution of services to the economy. Some of the confusion arises from the fact that in the traditional economy, goods marked are tangible. On the other side, services are mostly intangible and its definition covers extremely wide variety of elements of the economic activities which goes from tourism to health, to food to finance and from entertainment to commerce. However, as we have seen in the past 30 years in developed countries, a big opportunity for growth lies in the service sector.

The lack of a general understanding of the role of service sector has not prevented the population to exploit service sector opportunities. Ecuador has 49.7% of its work force in "underemployment". Underemployment mainly occurs in the service sector. Food services, merchandising, sales, and transport are some of the areas where informally, many Ecuadorians have found a growing opportunity. Our streets and corners are in fact "informal shopping centers". Because it is very hard to track, and informality, it is generally believed that official figures in GDP is underreported. This phenomenon has been documented by author Hernando de Soto. Today we see a vibrant service economy functioning in the streets.

Authorities have not responded to the rapid growth of this service economy. The delays are in the local and international levels. In the local levels, the service economy has not been fully integrated into the "legal" system. In international negotiations, services come after traditional goods negotiations. Our country has bilateral and multilateral agreements covering a wide variety of goods, but none that cover trade in services. Trade disputes continue to be at the heart of trade in goods.

Service negotiations deal with a variety of local restrictions, some of them built in laws, regulations and tax issues. The liberalization of goods trade has been focused on reducing tariffs. WTO can show important achievements in trade openness as world average tariffs have been reduced substantially. However, non-tariff barriers have been more difficult to address, and the WTO still is looking for effective mechanisms to reduce them. The issue at stake is that services liberalization demand changes deeper into the country's legal system, similar to those non-tariff barriers. There is a big challenge to our negotiators, legislators and authorities to lead the country to take the opportunities ahead. Removing those barriers to service openness is an extremely difficult task.

In our foremost integration process, the Andean Community, the services trade agreement is still far from concluded, and the debate continues on how to attain liberalization. It has become clear, that liberalization is neither desired, nor is there pressure from society to liberalize this sector. Much has been discussed on goods trading, but little advances in services. The population has not visualized the benefits of the bigger service area, thus there has been no pressure to the authorities to move forward.

As we have seen, the country has stayed out of big service sector growth opportunities. On the other hand, in the local economy economic agents have taken opportunities in the growing service sector. The review is mixed and in order to take full advantage of the international opportunities in the service sector, we need our society to visualize in order building support to open services.

In order to advance in the service trade liberalization from the national strategy we propose to basic actions that could create the conditions for a wider support in then society and yield results for the increased wealth of the country.

> Decouple goods from services negotiations. In the last few years, service negotiations have been put after goods negotiations. We believe that it is necessary to advance in services liberalization ahead of goods liberalization. Furthermore, as explained, the economy as a whole requires that the service sector have an openness similar to that already attained in the goods trade. Advancement in services should not make contingent on goods trade success. It is necessary to decouple service negotiations from sensible goods negotiations, in order to avoid unnecessary resistance from the agricultural and old industry sectors. To achieve the decoupling, some small steps are necessary in order to achieve a larger success.
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> Similar to good liberalization, it is necessary to complete limited reach agreements. This limited reach agreement should be designed to deliver tangible results to society. The results should be measurable in terms of increased wealth to the partners. The agreements should built on results, to move towards a broad agreement.