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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

THE EXTERNAL DEBT OF ECUADOR

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Economic Department
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THE EXTERNAL DEBT OF ECUADOR

SULJARY

Ecuador's external debt comprises two main parts, namely, an "old" debt arising from the financing of the Guayaquil and Quito Railway in the late 1890's, and held largely in Britain, and a "new" debt which consists of intergovernmental credits extended to Ecuador since the beginning of World War II, primarily obligations to the U. S. Export-Import Bank.

The amounts of principal outstanding as at July 1949 totalled some $23.4 million, of which the "old" and "new" portions were some $12.5 million and $10.9 million respectively; this total, however, will increase to $31 million as undisbursed Eximbank credits of $7.6 million are fully utilized. The net external principal liability, however, should not exceed $27 million since an estimated $4 million of the "old" debt is believed to be owned by the Ecuadorian Government. Finally, and in addition to the above, interest arrears on the "old" debt have accumulated to nearly $20 million.

The servicing records of the two debts provide a sharp contrast. Payments of interest and principal on the "old" debt have been consistently poor. No service payments have been made on the "old" debt since 1929. Of some $14.8 million principal authorized and issued, over $12.5 million still remains outstanding, and interest arrears of $19.7 million exceed the outstanding principal by over $7 million. The "new" debt, however, has been consistently serviced and no default on either interest or principal has been recorded to date.

Although various offers have been made and discussions have taken place between the Ecuadorian Government and the British Council of Foreign Bondholders
II.

concerning a settlement of the "old" obligations (the last Ecuadorian offer was made in 1945), no agreements have been announced to date.

Assuming that the 1948 Chilean debt settlement terms were used as a basis for resuming service of the "old" debt; that one third of the "old" debt was held internally; and that Eximbank credits are drawn down on their closing dates, the annual external servicing charges for both the "old" and "new" debts would total some $1.5 million in 1949, rising to a maximum of $2.3 million in the early 1950's and declining gradually thereafter.
THE EXTERNAL DEBT OF ECUADOR

1. The present outstanding external debt of Ecuador totals approximately $23.4 million, which will increase to $31 million as the undisbursed portion (approximately $7.6 million) of present Eximbank credits granted is fully utilized. In addition, interest arrears have accumulated on prewar debt to some $19.7 million. Part of the outstanding principal (estimated at some $4 million), is owned by the Ecuadorian Government itself, so that the present net foreign claims outstanding are reduced to $19.4 million. Therefore, the net figure, including the undisbursed Eximbank funds, will total $27 million, apart from the interest arrears.

2. The debt falls sharply into two portions, i.e. "old" and "new". The "old" part was incurred at the start of the century, and arose almost entirely from the financing of the Guayaquil and Quito Railway. Although denominated in dollars, the bonds appear to be held largely in Britain. The servicing record of this loan has been very poor throughout, and since 1929 no payments have been made whatsoever. Of the $23.4 million outstanding principal as mentioned above, the "old" debt represents approximately half, i.e. $12.5 million, and the interest arrears on this "old" debt total some $19.7 million.

The "new" debt consists exclusively of intergovernmental credits contracted during and after World War II, to the extent of $18.4 million, of which nearly $7.6 million has, so far (July 31, 1949), not been drawn. Apart from a debt to Venezuela of $0.5 million in connection with the Gran-Colombian shipping project, the "new" debt is owed wholly to the United States, predominantly in the form of Eximbank credits.

There have been no defaults to date on the "new" debt.
3. The "Old" Debt

Before World War II, Ecuador's external publicly subscribed bonded indebtedness resulted almost entirely from the Guayaquil and Quito Railway bond issues of 1899, guaranteed as to principal and interest by the Government. This railway company was originally incorporated in New Jersey (1897) and merged into a Delaware corporation of the same name and capital structure in 1940, and presently operates some 288 miles of rail lines from Duran to Quito under government concession. Pursuant to this concession, in 1968 the railway and equipment, in good working order and free from all liens and encumbrances, is to revert to the Government, to which the company shall have delivered (without indemnity) $5,250,000 of cancelled preferred stock, provided that all the government-guaranteed bonds have been paid off.

In 1925 the Government purchased $5,706,900 common and preferred stock (all par values of $100) for $600,000. This purchase, together with the 49% of the stock formerly held, gives the Government control of the company.¹

Under contracts of 1897/98, the Ecuadorian Government guaranteed the interest and principal for 33 years of $12,282,000 6% 1st mortgage bonds. In 1908 a new (negotiated) agreement was reached, to be the final settlement of all past disputes between the Government, the railway, and the bondholders. These

¹ The present status of the capital stock appears to be as follows:

<table>
<thead>
<tr>
<th>Type</th>
<th>Authorized and Issued</th>
<th>Owned by Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common: A</td>
<td>$3,445,680</td>
<td>$3,445,680 (100%)</td>
</tr>
<tr>
<td>&quot; : B</td>
<td>3,586,320</td>
<td>2,863,270 (80%)</td>
</tr>
<tr>
<td>&quot; : C</td>
<td>1,000</td>
<td>Nil</td>
</tr>
<tr>
<td>Preferred</td>
<td>5,250,000</td>
<td>2,843,100 (54%)</td>
</tr>
<tr>
<td></td>
<td>$12,283,000</td>
<td>$9,152,050 (75%)</td>
</tr>
</tbody>
</table>

The Class C Common stock is held by the Council of Foreign Bondholders in the interest of the bondholders. It has special voting rights, the right to appoint 3 directors, and is subject to redemption at par any time after all the government-guaranteed bonds have been redeemed.
1908 agreements provided, among other things, that interest and principal payments would be guaranteed by the Government so long as the bonds remained outstanding; that the interest rate would be reduced to 5% and holders would receive as compensation non-interest bearing certificates of £100 for every £1000 bond held, to be redeemed out of 25% of net earnings after providing for the bond servicing; the bonds were to have a first charge on Ecuador's entire customs revenue and all the property of the company; and that the Government should remit to the British Council of Foreign Bondholders the amount required for servicing the new authorized issue of £10,808,000 1st mortgage 5's (£1,474,000 of the original £12,822,000 issue had been cancelled by the Government under the same 1908 agreements). By 1909/10, however, the Government had defaulted on most of the terms of the new agreement. Although the Government had stated that after December 31, 1908, there would be no prior or pari passu charges on the customs revenues, steps taken by the Council in U. S. courts failed to recover moneys received out of customs receipts preferentially pledged to the bondholders. In March 1920, decree of the Ecuadorian Government was issued ordering 22% of import duties to be deposited for debt servicing, but it is understood that this decree was only partially observed. Despite repeated protests by the Council, no remittances were made by the Ecuadorian Government after 1929 in respect of external debt servicing. Sums allocated in the budget for this purpose and due July 2, 1929/31 were apparently deposited in a local bank without being used, but by 1931 even these deposits were discontinued.

The three other issues comprising the "old" debt have all been related, directly or indirectly, to the Guayaquil Railway. The Condores 4's for instance were issued to the railway company in exchange for certain old bonds of the Ecuadorian Government previously held in the company's portfolio. Originally this issue was to have been serviced by a specified percentage of Ecuador's customs receipts, but in 1908 the entire customs revenue was preferentially
pledged to the mortgage bondholders. The reason for the issuance of the non-interest bearing certificates has been mentioned on page 3, and the 4% salt bonds of 1908 were issued mainly in exchange for three coupons (January 1908/09) due on the 1st mortgage 5's.

Although expressed in dollars this debt was in reality a British loan, and most\(^1\) of the defaulted bonds (approximately 2/3) are now presumed to be held in Britain, the balance by the Government of Ecuador. These issues have consistently shown a poor servicing record, both as to interest and amortization of principal. The July 1949 situation concerning this "old" debt appears to be as follows:

(U.S. Dollars Thousands)

<table>
<thead>
<tr>
<th>Type of Issue and Denomination</th>
<th>Authorized and Issued</th>
<th>Principal Outstanding</th>
<th>Interest Arrears</th>
<th>Last Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. 5% 1st mtg. bonds of Guayaquil and Quito RR, 1908 = 10,808</td>
<td>10,722</td>
<td>19,000</td>
<td>1929 (1914 coupon)</td>
<td></td>
</tr>
<tr>
<td>1899-1932 (2,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Non-interest bearing certificates, compensation for reduction of interest from 6% on above, 1908 ($100)</td>
<td>1,080</td>
<td>1,080</td>
<td>-</td>
<td>none</td>
</tr>
<tr>
<td>3. 4% Salt Bonds, secured on Salt Monopoly and issued for purpose of funding 1908/9 coupons on Ry bonds, 1908 ($90)</td>
<td>1,075.05</td>
<td>459.9</td>
<td>377</td>
<td>Coupons paid to 1929.</td>
</tr>
<tr>
<td>4. 4% Gold Condores Bonds, 1901-1934 ($400)</td>
<td>311.6</td>
<td>287.2</td>
<td>333</td>
<td>1929 (1920 coupon)</td>
</tr>
</tbody>
</table>

| TOTALS | 14,748.65 | 12,549.1 | 19,710 |

There is also a French franc obligation to the Cie Francaise de Chemin de Fer l'Equateur dated 1909, on which no interest was paid. Due to its small dollar

\(^1\) Less than $1,000,000 is held by U.S. nationals.
total however (3,240,000 at the present franc rate)\(^{1/}\) and the fact that Ecuador has never formally admitted liability by including it in the official public debt statements, (the Government claims that the contractors did not fulfill all the requirements of their respective railroad and port contracts), it may be disregarded. Nevertheless, the Government appears to recognize some liability and has evidently engaged in some informal negotiations for its retirement.

In 1927 the Ecuadorian Government signed a contract with a Swedish syndicate (Kreuger's Swedish Match Co.), granting them a 25 year match monopoly, with the syndicate advancing a loan of 10,000,000 sucres at 8% (then $2,000,000) to the Government to be used as a guarantee fund for creating the Mortgage Bank of Ecuador. In 1931 the Ecuadorian Government cancelled this monopoly, (declaring it unconstitutional), and the cancellation was to involve repayment of the syndicate loan. In 1932, the outstanding bonds, totalling approximately $1.9 million, were reported to have been deposited as collateral for a loan in New York of the same amount, plus accrued interest. In January 1939 the Marine Midland Trust of New York concluded an agreement with the Ecuadorian Government and the Mortgage Bank, to settle the $1,879,290 8% match loan and $970,791 bonds of the Mortgage Bank which had also been held as collateral. In February 1939 the Marine Trust announced that it had received $750,312 in full settlement of the 8% bonds of the Government of Ecuador and 7% bonds of the Mortgage Bank held by it as part of the collateral. The settlement was on the basis of 22% of the principal amount of the bonds plus 22% of overdue interest, accrued at the reduced rate of 6% to December 1, 1935.

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\(^{1/}\) This dollar countervalue assumes the bonds to be denominated in French francs without a gold clause. One source - Moody's 1946 Governments - speaks of "gold francs" but this probably merely indicates pre-1914 francs and is the only source referring to "gold francs."
4. Contractual Service Record of the "Old" Debt

a) 1st Mortgage 5's

Principal: $1,560,000 has been retired to date out of the original $12,982,900 authorized and issued. However only $86,000 should be considered as a cash payment since $1,474,000 was cancelled by the Government under the 1908 agreements. Thus, sinking fund payments have been in default since 1908 except for 1913 when $71,000 of the bonds were retired and in 1928 when a partial year's sinking fund payment was made.

Interest: 3 coupons (January 1908 through January 1909) were surrendered for 4% Salt Bonds in 1908, and interest payments were apparently made until 1913. Thereafter and until 1929 only intermittent interest payments were made, i.e. January 1913 coupon paid in 1925; July 1913 paid in 1928; and January 1914 in 1929. No payments of any nature were made after 1929.

b) Others

No servicing whatsoever has been recorded for the non-interest bearing certificates of 1908.

During 1910-13, service on the Salt loan was delayed but coupons due January 1913 to July 1914 were met promptly and the sinking fund was provided for in 1914. Interest and sinking fund payments both went into default in 1915. Coupons due January 1915 to January 1917 were paid in 1920; due July 1917 to July 1918 in August 1925; due January 1919 to July 1925 (at a reduced rate of 3%) in 1925 and 1926; due January 1926 in February 1926; July 1926 was paid on due date; due January 1927 to July 1928 in July 1928; due January 1929 on due date. Subsequent interest payments have been defaulted. Sinking fund payments were resumed in 1926, not provided in 1927, resumed in 1928, but they too have lapsed since suspension in 1929.
The 4% Condores bonds of $311,600 were originally delivered by the Government to the railway in return for some former consolidated bonds issued at $333,600 of which some $22,000 had been paid off through a sinking fund. The last sinking fund payment on this issue (the one due in 1909) was made in 1920. Some interest payments were made after much delay, i.e. July 1912-January 1916 in 1928, and the last payment (coupons of July 1920) was made in January 1929.

In July 1929, bondholders were invited to deposit their bonds with the British Council of Foreign Bondholders and some $7,000,000 have been so deposited to date. Up to the present time no mutually acceptable arrangements have been made by the Ecuadorian Government and the Council for resumption of interest or sinking fund payments. The last offer by Ecuador was in 1945, when two alternative options were offered to each bondholder but neither proposal was accepted by the Council. As a result the outstanding principal still remains at $12,549,000, and the interest in arrears is some $19,710,000.

The differences between the Ecuadorian Government's last offer and the counter proposals of the Council do not appear to have been excessive so that it would not seem impossible to arrive at a mutually satisfactory settlement.

1/ Option 1. Resumption of interest at 2% on all bonds, and of sinking funds of 1% on the Guayaquil and Quito and Condores Bonds, and 4% on the Salt Bonds. Arrears of interest were to be renounced, and a cash payment of 4% was to be made on each outstanding bond whose holder accepted these terms.

Option 2. The Government to purchase bonds of any of the three loans at 40% of the nominal value.

The Council proposed that these options be amended as follows:

Option 1. Interest on G. and Q. bonds to be 2%. After the redemption of the Salt Bonds, their debt service was to be applied to the other issues.

Option 2. To take account of the different proportions between principal and arrears on the different issues, the purchase offer to be 20% of principal plus arrears instead of 40% of principal.
5. The "New" Debt. No external publicly subscribed bonds have been floated by Ecuador since the abovementioned issues. During and after World War II, however, Ecuador has incurred intergovernmental loans totalling $18.4 million (with some 94% being Eximbank credits), of which the undisbursed Eximbank funds totalled nearly $7.6 million as at July 31, 1949. The non-Eximbank items still outstanding total some $984,000, representing a Surplus Property advance by the U. S. Government, and a shipping debt to Venezuela of $500,000 in respect of the mutual Gran-Colombian shipping project. There also appears to be a small Lend-Lease obligation to the U. S. Government, details of which are kept confidential.

The July 1949 situation concerning the "new" debt appears to be as follows:

<table>
<thead>
<tr>
<th>Lender</th>
<th>Purpose</th>
<th>Principal Outstanding</th>
<th>Amount Undisbursed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Eximbank</td>
<td>Mainly highways and waterworks</td>
<td>9,888,437 (7/31/49)</td>
<td>7,571,900 (7/31/49)</td>
</tr>
<tr>
<td>2. U.S.Govt.</td>
<td>Surplus Property</td>
<td>484,276</td>
<td></td>
</tr>
<tr>
<td>3. Venezuelan Govt.</td>
<td>Joint Shipping Company</td>
<td>500,000*</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>10,872,713</strong></td>
<td><strong>7,571,900</strong></td>
</tr>
</tbody>
</table>

* The amount repaid, if any, and the terms of repayment are not available.

6. Contractual Service Record of "New" Debt. Although information is not available as to the amount repaid or the terms of repayment for the small U. S. Government Lend-Lease obligation and the Venezuelan Government joint shipping loan ($500,000), there has been no indication of default on either. There has also been no default to date on the Eximbank credits.

7. Future Servicing Charges.

   A. "Old" Debt. Possible future annual service charges on the total Ecuadorian external debt could only be determined after a settlement of the "old" debt
has been agreed upon. However, in the absence of such a settlement, these charges could be estimated on the basis of the following assumed plans:

(1) Using the new (1948) Chilean settlement,1/ with an additional clause requesting that 10% of the present interest arrears be exchanged for identical new bonds: this basis would result in $1,971,000 new bonds being issued to settle the outstanding interest (and thus increasing the total principal outstanding to $14,520,100), and an annual service charge rising from $363,000 in 1949 to $546,000 in the seventh and succeeding years. If, however, one-third of the bonds are assumed to be held internally, the above totals would be reduced to $1,320,000 as bond settlement for interest arrears (making the total principal outstanding $9,680,000), and annual service charges to be transferred abroad would rise from $240,000 in 1949 to $360,000 in the seventh and succeeding years.

(2) Using Ecuador's 1945 Option 1 2/: This form of settlement would result in a cash payment of $500,000 if all bondholders accepted these terms, and an annual service charge of $390,000. If again we assume one-third of the bonds to be held internally, the above totals would be reduced to $330,000 as a cash settlement, and an annual service charge of $260,000.

B. "New" Debt. On the assumption that undisbursed Eximbank credits are drawn down by the respective closing dates, the service of the "new" debt (excluding the Lend-Lease and Venezuelan advances) would rise from approximately $1,250,000 in

1/ New bonds, par for par, to mature in 45 years, bearing interest rising from 1% at the outset to 3% after the fifth year, with a sinking fund for the first five years at 1% of the total amount in default and thereafter at the rate of 1% of the bonds outstanding each year.

2/ See footnote 1/ Page 7.
1949 to a maximum of some $1,900,000 in 1951, declining gradually thereafter.

Thus, on the basis of the assumptions outlined in settlements A(1) and B above, and assuming that one-third of the "old" bonds are held internally, the external service costs for 1949 would total some $1,500,000, rising to a peak of approximately $2,300,000 and declining gradually thereafter. About five-sixths of the above assumed servicing totals pertain to the "new" debt which, as previously mentioned, has been regularly serviced to date.

C. Servicing Ability. The first two columns of the table below indicate the dollar value of Ecuador's total exports and holdings of gold and foreign exchange before and after World War II. The last two columns show the ratio of external servicing charges (calculated on the basis of assumptions as given in footnotes 2/ and 3/) to Ecuador's total and U.S.-directed exports.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Exports</th>
<th>Gold and Foreign Exchange</th>
<th>Estimated External Debt Servicing Charges as a Percentage of Total Exports Exports to U.S.A.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1937</td>
<td>13.05</td>
<td>5.3</td>
<td>3.9% 1/</td>
</tr>
<tr>
<td>1938</td>
<td>9.38</td>
<td>3.8</td>
<td>5.3% 2/</td>
</tr>
<tr>
<td>1946</td>
<td>38.50</td>
<td>36.5</td>
<td>5.2% 3/</td>
</tr>
<tr>
<td>1947</td>
<td>44.70</td>
<td>26.6</td>
<td>4.5% 3/</td>
</tr>
<tr>
<td>1948</td>
<td>47.90</td>
<td>27.9</td>
<td>4.2% 3/</td>
</tr>
<tr>
<td>1949</td>
<td>35.00(est.)</td>
<td>25.7(June)</td>
<td>5.7% 3/</td>
</tr>
</tbody>
</table>

1/ All data obtained from IMF International Financial Statistics, July 1949, except the 1948 export total (taken from statements of Ecuador's Central Bank) and the 1949 export total (IBRD estimate).

2/ Servicing charges for 1937/38 (totaling approximately $500,000 annually) were calculated by using contractual interest and sinking fund rates for the "old" debt, but neglecting any settlement of past interest arrears.

3/ The annual service charges for 1946-49 were taken at the round total of $2,600,000, i.e. as an approximate average of the high and low figures ($2,300,000 and $1,500,000) following from the assumptions in paragraph B above. Present estimates, indicating a reduction in Ecuador's 1949 exports to
some $35,000,000, would give a servicing/export ratio of nearly 6% for that year. If Ecuador's postwar export level remains between $30 and $40 million (at an annual average of $35,000,000) and the peak annual servicing charges are $2,300,000, the maximum ratio of service charges/exports would be 6.6%. This implies that the ratio for 1949 and following years will be slightly higher than for the previous years.

It should be noted, however, that if Ecuador's exports fell to the 1937 level (Ecuador's highest export total during the decade 1931/40), the peak service costs of $2,300,000 would result in the much higher service/exports ratio of some 17%. Furthermore, when viewing Ecuador's external service costs in relation to its U. S. exports alone, it is seen that this ratio is some two to three times greater than is the case when Ecuador's total exports are used. The relevancy of using the U. S. export totals must be taken into consideration in the present era of inconvertible currencies. 1/

1/ That the "old" debt is largely British-owned does not affect the fact that the bonds are denominated in, and must be serviced in, dollars.