



## CRS Report for Congress

# Ecuador: Political and Economic Situation and U.S. Relations

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### Summary

President-elect Rafael Correa, a left-leaning, U.S.-trained economist, is scheduled to take office on January 15, 2007. Correa, who will become Ecuador's eighth president in ten years, defeated Alvaro Noboa, a wealthy banana magnate, in a run-off election held in late November 2006. Correa has vowed to dramatically reform Ecuador, a country whose economy is currently expanding because of high oil prices but whose political institutions are extremely fragile. He has promised to call a constituent assembly to reform the country's constitution, to renegotiate Ecuador's foreign debt, and to reassert state control over foreign oil companies operating in the country. These proposals, though popular among many Ecuadorians, have prompted concerns among foreign investors. Ecuador has traditionally had close relations with the United States, although recent trade disputes have strained bilateral relations. U.S. officials congratulated Correa on his recent victory and pledged to cooperate with his government but have also expressed concerns about his ties with Hugo Chávez of Venezuela and his stated policies regarding trade, energy, and counternarcotics matters. This report will be updated periodically. For more information, see CRS Report RS22548, *ATPA Renewal: Background and Issues*, by M. Angeles Villarreal.

### Background

Slightly smaller than Nevada, Ecuador has a population of 13.4 million people. Since independence from Spain in 1830, Ecuador lost 61% of its total land area as a result of border conflicts with Brazil, Colombia, and Peru. Despite its small size, Ecuador's location on the Pacific Coast between Colombia and Peru, two major drug producing countries, increases its strategic importance to the United States. In 2006, Ecuador was the 9<sup>th</sup> largest oil supplier to the United States, and the 3<sup>rd</sup> largest supplier (behind Mexico and Venezuela) in Latin America. Ecuador is both geographically and ethnically diverse, and has a relatively long (albeit unstable) experience with democratic rule. The population is ethnically mixed: 65% mestizo (mixed Indian and Spanish descent), 25% indigenous, 7% Caucasian and others, and 3% African. Some 61% of the non-indigenous

population and 87% of indigenous Ecuadorians live in poverty.<sup>1</sup> Although Ecuador returned to civilian rule in 1979, the political situation there has often been unstable.

## Political Context

Ecuador was once considered a relatively stable country located in the conflicted Andean region. In the past decade, however, Ecuador has weathered a number of serious political and economic crises. The three last popularly elected presidents of Ecuador did not complete their terms. In 1997, Abdala Bucaram was removed from office constitutionally after being declared mentally unfit by the legislature and allegedly misappropriating \$90 million in public funds. In 2000, Jamil Mahuad was ousted by a coup after a prolonged economic crisis led by a junta that included then-army Colonel Lucio Gutierrez. In April 2005, Lucio Gutierrez was removed from office by Ecuador's Congress after weeks of popular protests.<sup>2</sup> Ecuadorians rejected Gutierrez's replacement of the majority of the judges on the country's three highest courts with his political allies, a move that had been sharply criticized by the international community.

There are historical antecedents for the instability that has plagued Ecuadorian democracy. Since 1830, regionalism and personalism have defined Ecuadorian political culture. Quito, the colonial capital, and Guayaquil, the industrial port, have battled for urban dominance. Superimposed against this regional divide are the ethnic and class divisions that have encouraged political parties to develop as electoral machines for competing segments of the elite. Following the return to democracy in 1979, party splits, bureaucratic ineptitude and rampant corruption proliferated. Important reform measures — civil service reform, tax laws, banking regulation — stalled in a Congress dominated by fragmented parties and vocal opponents with vested interests to protect. As the economic situation has deteriorated since the 1980s, voters have reacted by blaming incumbents for their troubles and by periodically backing populist, anti-party candidates. This trend, coupled with the country's economic problems and rampant corruption, has led to inconsistent economic and political policies from one administration to the next, and to the inability of elected presidents to complete their terms.

**Rafael Correa.** President-elect Rafael Correa, a left-leaning, U.S.-trained economist, is scheduled to take office on January 15, 2007. Correa, who will become Ecuador's eighth president in ten years, defeated Alvaro Noboa, a wealthy banana magnate, in a run-off election held in late November 2006. Contrary to analysts' predictions, Correa won the election decisively with 57% of the vote as compared to Noboa's 43%. Correa will succeed Alfredo Palacio, a political independent and former vice president, who has served as president since taking over for Lucio Gutierrez in April 2005. The Palacio Administration has been severely weakened by frequent cabinet turnover, a failure to gain congressional support for a constituent assembly in 2005, and ongoing popular protests.

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<sup>1</sup> Gillette Hall and Harry Patrinos, *Indigenous Peoples, Poverty and Human Development in Latin America, 1994-2004*. Washington: The World Bank, 2005.

<sup>2</sup> The Bush Administration and the Organization of American States (OAS), though opposed to Gutierrez's actions, expressed some concerns about the constitutionality of his removal and replacement. "'Constitutional Coup' by Congress Ousts Gutierrez on Wave of Popular Protests," *Latin News Weekly Report*, Apr. 26, 2005.

Correa has vowed to dramatically reform Ecuador, a country whose economy is currently expanding because of high oil prices but whose political institutions are extremely fragile. He has promised to call a constituent assembly with power to reform the country's constitution and dissolve its congress, to renegotiate Ecuador's international debt, and to reassert state control over foreign oil companies operating in the country. These proposals, though popular among many Ecuadorians, have prompted serious concerns among foreign investors. Many analysts predict that Correa will have a difficult time enacting his agenda given that his party lacks representation in the legislature, a notoriously fractured institution that is now dominated by Noboa's party and others opposed to a constituent assembly.<sup>3</sup>

**Corruption.** According to Transparency International's 2006 Corruption Perceptions index, Ecuador and Venezuela are perceived to be the most corrupt nations in Latin America after Haiti. During the Gutierrez government, the March 2005 supreme court decision to drop charges pending against several former Ecuadorian leaders accused of corruption added to the perception that Ecuador is rife with official corruption. Polls have revealed that a majority of Ecuadorians believed that corruption was as pervasive in the Palacio government as it was under Gutierrez.<sup>4</sup>

**Human Rights.** The State Department Human Rights report on Ecuador covering 2005 states that "while the government generally respected the human rights of its citizens ... there were serious problems in some areas." Those problems include the abuse and unlawful killing of suspects and prisoners by security forces, as well as poor prison conditions. The U.S. State Department placed Ecuador on the Tier 3 list of countries not taking adequate measures to combat trafficking in persons in 2004 and 2005, but the country's improved efforts resulted in a Tier 2 ranking in the 2006 report.<sup>5</sup> Alien smuggling is also a major problem. In August 2005, some 90 Ecuadorians perished when an overcrowded boat of migrants bound for the United States sank in the Pacific Ocean.

**Role of the Indigenous.** Ecuador's indigenous population resides primarily in the country's highland and Amazonian regions. Indigenous peoples have been among the most disadvantaged, under-represented groups in Ecuador. Since 1990, however, they have organized two of the most powerful indigenous organizations in Latin America: the Confederation of Indigenous Nationalities of Ecuador (CONAIE) and the Pachakutik political party. Although Pachakutik currently holds seats in the Congress, indigenous groups have gained more notoriety for their mass protests than for their electoral successes. The participation of Pachakutik in the Gutierrez government marked the first time in the country's history that an indigenous-based political party participated in a governing coalition. Some observers argue that the short-lived duration of that coalition has weakened the movement's popularity, noting the declining attendance at recent indigenous protests and the fact that its leadership is currently divided.

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<sup>3</sup> "Correa Has Clear Priorities," *Oxford Analytica*, December 12, 2006.

<sup>4</sup> "Ecuadorians Enduring a Tumultuous Democracy," *Miami Herald*, Aug. 29, 2005.

<sup>5</sup> U.S. Department of State, *Trafficking in Persons Report, 2006*, June 5, 2006, online at [<http://www.state.gov/g/tip/rls/tiprpt/2006/65983.htm>].

## Economic Situation

In 1999-2000, Ecuador suffered a disastrous economic crisis, the country's worst in more than seventy years, characterized by numerous bank failures, hyperinflation, double-digit unemployment and an eventual currency collapse. The crisis revealed the deleterious effects that external shocks can have on a weak and poorly regulated economy that is overly dependent on a few export commodities — oil, shrimp, and bananas — with volatile prices.<sup>6</sup> In late 1999, then-president Jamil Mahuad abandoned the country's domestic currency in favor of the U.S. dollar as a last-ditch effort to stop hyperinflation. Dollarization was also a calculated political maneuver, though ultimately unsuccessful, to preserve the Mahuad administration. Mahuad's successor, Gustavo Noboa, followed through on the dollarization plan. As a result, inflation subsided and, boosted by high oil prices, the economy grew by 5.1% in 2001 and 3.4% in 2002. The Noboa government then created a stabilization fund using excess oil revenue and improved the country's tax system. Rather than agreeing to a renewal of a stand-by agreement with the IMF, President Noboa responded to popular demands for increased government spending.

In January 2003, President Lucio Gutierrez began his administration by appointing a pro-market finance minister who was able to help him secure a \$205 million IMF stand-by agreement. In order to comply with IMF requirements, the Gutierrez government attempted to restrict public spending, increase taxes, remove subsidies, and promote private investment in the oil sector. These efforts spawned sustained popular protests. Although the economy grew some 6.3% in 2004 as a result of high oil prices, remittance flows, and a weak U.S. dollar, a lack of fiscal discipline postponed the renewal of a new IMF stand-by agreement. According to Ecuadorian government officials, the country received only 10% of the \$500 million in multilateral loans that had been budgeted for 2005. Throughout the Palacio administration, investors have been concerned by the Ecuadorian government's lack of fiscal discipline and hostile actions towards foreign companies. They are reportedly even more nervous about the views expressed by President-elect Correa, particularly his failure to rule out the possibility of an "Argentina-style" default on Ecuador's \$11 billion debt.<sup>7</sup>

**Energy Industry.** Oil exports are extremely important to Ecuador's economy, accounting for some 60% of total exports in 2005. High oil prices fueled GDP growth of 4.7% in 2005 and an estimated 4.2% in 2006. Production by Petroecuador, the state-owned oil company, has fallen by 50% in the last ten years, and a lack of capital has forced the company into a deep financial crisis.<sup>8</sup> Private companies have had a difficult time investing in the Ecuadorian oil industry owing to the country's chronic instability and tendency for conflicts with private producers. Both state and private production was hurt in August 2005 by protests in two oil-producing provinces led by indigenous groups demanding more public works projects funded by oil revenues, as well as March 2005 protests against a proposed free trade agreement (FTA) with the United States. Ecuador

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<sup>6</sup> Paul Beckerman and Andrés Solimano, *Crisis and Dollarization in Ecuador*, Washington, D.C.: World Bank, 2002.

<sup>7</sup> "Investors Wary of Ecuador's President-Elect," *Financial Times*, January 3, 2007.

<sup>8</sup> "DJ Petroecuador Ex-President: Company Faces Deep Financial Crisis," *Dow Jones Commodities Service*, Feb. 10, 2006.

has moved to capture more of the windfall profits from foreign oil companies operating in the country, and in mid-May 2006 terminated the contract of Occidental Petroleum after a long dispute over whether the company had broken laws in selling some of its oil-drilling rights in Ecuador to a Canadian firm. Ecuador will now send crude oil produced in fields formerly run by Occidental to Venezuela for processing. The U.S. government responded to this contract termination by condemning Ecuador's failure to respect foreign investment and suspending FTA negotiations indefinitely.<sup>9</sup>

## Relations with the United States

Ecuador's relations with the United States are generally good, although recent trade disputes have strained bilateral relations. The limited amount of U.S. assistance Ecuador has received in comparison to other Andean nations has also been a contentious issue. Ecuador is located at the epicenter of the most conflicted region in the Western Hemisphere and cooperates with the United States in the containment of Colombian guerrillas and the fight against illicit narcotics. Although the United States has concluded FTAs with Peru and Colombia, negotiations for a bilateral free trade agreement with Ecuador have been suspended indefinitely in the wake of the Occidental incident. The U.S. government is also concerned about Ecuador's high level of corruption, endemic poverty, chronic political instability, and burdensome foreign debt.

Several issues could complicate U.S.-Ecuadorian relations early in the Correa government. For example, Correa has pledged to raise taxes and exert more state control over U.S. and other foreign oil companies. He opposes completing FTA negotiations with the United States and is not willing to restart negotiations as a condition to continue receiving U.S. trade preferences under the Andean Trade Preferences and Drug Eradication Act (ATPDEA), which are due to expire on June 30, 2007. President-elect Correa has recently confirmed that his government will not renew the lease on the U.S. air base at Manta, which is currently used for U.S. aerial counter-drug detection and monitoring operations, when it expires in 2009. He has expressed reservations about any Ecuadorian involvement in Plan Colombia and publicly opposed the Colombian army's incursions into Ecuadorian territory and the Colombian government's recent resumption of aerial fumigation along the Ecuador-Colombian border.

Some analysts have urged the U.S. government to adapt a similar policy towards the Correa government in Ecuador as it has with the Morales government in Bolivia. They maintain that the United States has the ability to influence Ecuador in terms of foreign aid, trade preferences, and international finance. They urge U.S. officials not to antagonize Correa, but to use pragmatic, low-profile means to urge him to maintain open-market and democratic policies.<sup>10</sup>

**Counter-Narcotics Cooperation.** Ecuador, a major transport country for cocaine and heroin, has worked closely with the United States in its counter-narcotics efforts. In November 1999, the United States signed a 10-year agreement with Ecuador for the creation of a forward operating location (FOL) at Manta, an air force base along

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<sup>9</sup> "Ecuador: Ecuador Falling Under Chávez's Spell," *Latin American Regional Report*, June 2006.

<sup>10</sup> "Correa Wins, But How Long Will he Last?" *Latinnews Andean Report*, December 2006; "Correa's Triumph," *Financial Times*, November 28, 2006.

the Pacific Coast, for U.S. aerial counter-drug detection and monitoring operations. Ecuador issued a new national drug strategy in 2004, and has increased the number of police and military posted along its northern border with Colombia. Total cocaine seizures amounted to 44 metric tons in 2005 as compared to 5.8 metric tons in 2004. Ecuador received an estimated \$20 million in U.S. counternarcotics assistance for FY2006. The Administration requested \$17.5 million in assistance for FY2007 as part of the Andean Counterdrug Initiative, but Congress has not yet completed action on the FY2007 Foreign Operations spending measure.

**U.S. Aid.** The United States is the largest bilateral donor in Ecuador, allocating an estimated \$33 million in total assistance to Ecuador in FY2006. Four USAID goals for Ecuador are bolstering democracy, reducing poverty, protecting the environment, and securing the border. On July 1, 2003, the Bush Administration cut off certain forms of military aid to Ecuador for not signing an Article 98 agreement, exempting U.S. service members from the jurisdiction of the International Criminal Court. In FY2005, Economic Support Funds (ESF) were also cut because of the lack of an Article 98 agreement, though most of this assistance was reprogrammed through non-governmental organizations. Although restrictions on ESF remain, the John Warner National Defense Authorization Act for FY2007 (P.L. 109-364), enacted on October 17, 2006, removes restrictions on military aid to Ecuador and other countries that are members of the ICC and that do not have Article 98 agreements in place.

**Trade.** The United States is Ecuador's main trading partner. The United States exported \$1.9 billion in goods to Ecuador in 2005, with machinery and plastics the leading items. The United States imported \$4.9 billion in Ecuadorian goods, primarily oil, bananas, and shrimp. Some 45% of Ecuadorian exports go to the United States. Since joining the World Trade Organization (WTO) in 1996, Ecuador has lowered its average tariff rate from 30% to 13%, but a number of non-tariff trade barriers, such as denying import permits and tough sanitary controls, impede U.S. access to the Ecuadorian market.

Since 1992, Ecuador has been a beneficiary of the Andean Trade Preference Act (ATPA). Although oil continues to dominate its export market, other goods, such as seafood and cut flowers, have benefitted from the program. The ATPA was reauthorized and expanded to become the Andean Trade Promotion and Drug Eradication Act (ATPDEA), Title XXXI of the Trade Act of 2002, enacted on August 6, 2002 (P.L. 107-210). The law extended the preferential trade program until December 31, 2006, and expanded it to include certain textiles, petroleum, and pouched tuna. Congress recently voted to extend those trade preferences for six months and for an additional six months if a country enters into a free trade agreement with the United States. Although the United States has concluded FTAs with Peru and Colombia, negotiations for a bilateral free trade agreement with Ecuador have been suspended indefinitely in the wake of the Occidental contract termination. President-elect Correa opposes completing negotiations of a free trade agreement with the United States and is not willing to restart negotiations as a condition to continue receiving U.S. trade preferences under the ATPDEA, which are now due to expire on June 30, 2007.<sup>11</sup>

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<sup>11</sup> See CRS Report RS22548, *ATPA Renewal: Background and Issues*, by M. Angeles Villarreal.