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

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Summary

On April 20, 2005, President Lucio Gutierrez was removed from office by Ecuador's Congress following weeks of popular protests. Ecuadorians rejected Gutierrez's December 2004 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. Succeeding him as President was his former vice president, Alfredo Palacio, a physician and political independent. Palacio is the country's seventh president in nine years. Ecuador's economy is currently expanding because of high oil prices, but its political institutions are extremely fragile. The Palacio Administration has already been weakened by cabinet resignations, allegations of corruption, and a failure to gain congressional support for a constituent assembly. Ecuador continues to work with the United States on counter-narcotics matters and is expected to soon resume negotiations for a U.S.-Andean Free Trade Agreement. Despite this cooperation, investors are concerned by Palacio's lack of fiscal discipline, including his support of a congressional measure to channel oil revenue into social spending rather than debt repayment. This report will be updated periodically.

Background

Slightly smaller than Nevada, Ecuador has a population of just under 13 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. Ecuador is the 12th largest oil supplier to the United States, and the 3rd 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: 55% mestizo (mixed Indian and Spanish descent), 25% indigenous, 10% Caucasian, and 10% African. Some 61% of the non-indigenous

population and 87% of indigenous Ecuadorians live in poverty.¹ Although Ecuador returned to civilian rule in 1979, the political and economic situation there has often been unstable. Political stability in Ecuador is threatened by such forces as poverty, corruption, political fragmentation, and the need to balance popular demands and fiscal reforms.

Political Context

Ecuador was once considered a relatively stable country located in the conflicted Andean region. In recent years, however, Ecuador has weathered a number of serious governmental and economic crises. Lucio Gutierrez is Ecuador's third consecutive popularly elected president that did not complete his term. In 1997, Abdala Bucaram was removed from office constitutionally after being declared mentally unfit by the National Congress and allegedly misappropriating \$90 million worth of 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. Although he is currently in prison in Quito on charges of sedition, Gutierrez has announced his intention to run in the next presidential elections that are scheduled to be held in October 2006.

There are historical antecedents for the instability that has plagued Ecuadorian democracy. Since 1830, regionalism and personalism have defined Ecuadorian political culture. Throughout the country's history, 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 (such as Lucio Gutierrez). 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.

Ecuador's dependence on oil exports and remittances, vulnerability to natural disasters, high levels of foreign debt, and central location within the volatile Andean region have made it extremely vulnerable to exogenous shocks. The country's inefficient policy-making process, a system in which a plethora of competing economic and political interests compete for political spoils, has tended to inhibit the success of policy initiatives and failed to shield the country from external shocks.²

Gutierrez Administration. Inaugurated in January 2003, President Gutierrez abandoned his populist record and adopted some market-friendly reforms in order to secure support from the International Monetary Fund (IMF). His power was severely

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

² Mejia-Acosta, Andres et al. "Political Institutions, Policymaking Processes, and Policy Outcomes in Ecuador," FLACSO-Inter-American Development Bank, August 2004.

limited, however, by opposition parties that dominated the Congress, indigenous protests, and allegations of corruption. Despite his party's poor performance in the October 2004 municipal elections, President Gutierrez was able to stave off impeachment proceedings in November 2004 by forming a new legislative alliance that included former President Bucaram's party. In December 2004, Gutierrez used that support to pack three of the country's highest courts with his political allies, who later dropped all corruption charges against Bucaram and other former leaders, thereby allowing them to return to Ecuador. This move was denounced by the United Nations and the Inter-American Commission of Human Rights (IAHCR).³ 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.⁴

The Palacio Administration. President Palacio has no party affiliation, congressional allies, nor grass-roots supporters to promote his policy choices. Since April 2005, there have been 33 cabinet changes in the Palacio government. The Ecuadorian Congress has thwarted Palacio's efforts to deliver on his promises to convoke a constituent assembly to reform the constitution and to revise the supreme electoral court (TSE). Investors have expressed concerns that Palacio has increasingly turned to populist measures, such as diverting oil revenues to social projects rather than debt repayment and returning pension contributions to individuals. These policies could jeopardize needed IMF and multilateral funding. In December 2005, Palacios had an approval rating of only 21% and some 81% of Ecuadorians polled felt that the April 2005 change of government had "not been worthwhile."⁵

Corruption. According to Transparency International, Ecuador is perceived as the second most corrupt nation in Latin America after Paraguay, with a level of corruption rivaling that of the Democratic Republic of the Congo, Iraq, and Sierra Leone. In 2003, arms trafficking scandals threatened to undermine the generally positive reputation of one of the country's most respected political institutions, the Ecuadorian military. Although former President Bucaram has since returned to Panama, the March 31, 2005 supreme court decision to drop charges pending against him and other former Ecuadorian leaders accused of corruption has probably added to the perception that Ecuador is rife with official corruption. A July 2005 poll revealed that a majority of Ecuadorians believed that corruption was as pervasive in the Palacios government as it was under Gutierrez.⁶

Human Rights. The State Department Human Rights report on Ecuador covering 2004 states that "the Government generally respected the human rights of its citizens; however, there were problems in some areas." The report cited 21 killings by security forces in 2004, up from 11 in 2003. The IAHCR has expressed concerns about the fragility of the rule of law in Ecuador, and violence there against union and indigenous

³ Sandra Edwards, "Outside the Rule of Law: Ecuador's Courts in Crisis," *Washington Office on Latin America*, April 2005.

⁴ "'Constitutional Coup' by Congress Ousts Gutierrez on Wave of Popular Protests," *Latin News Weekly Report*, April 26, 2005.

⁵ "Rocky Start to the New Year for Palacio," *Latin News Daily*, January 3, 2006.

⁶ "Ecuadorians Enduring a Tumultuous Democracy," *Miami Herald*, August 29, 2005.

leaders.⁷ Ecuador recently passed a trafficking in persons law, but its enforcement and assistance to victims is extremely weak. In June 2004, the U.S. State Department placed Ecuador on the Tier 3 list of countries not taking adequate measures to combat trafficking in persons. Ecuador was able to avoid U.S. sanctions, however, by taking significant counter-trafficking actions by September 2004. In June 2005, Ecuador was again placed on the Tier 3 list for trafficking in persons, but will not face sanctions this year as it has been given a U.S. national interest waiver. Alien smuggling is also a major problem. In late August 2005, more than 90 Ecuadorians perished when an overcrowded boat of undocumented immigrants bound for the United States sank in the Pacific Ocean. Language in the House-passed version of the FY2006 and FY2007 Foreign Relations Authorization Act, H.R. 2601, would require the State Department to submit a cost-benefit analysis to Congress on the most effective ways to help deal with the problems of trafficking and alien smuggling in Ecuador.

Role of the Indigenous. Ecuador's indigenous population resides primarily in the country's highland and Amazonian regions. Indigenous peoples have historically 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. While Pachakutik currently holds 10% of the 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.

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 Ecuadorian financial 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 with volatile prices. From 1993-1997, Ecuador's three major exports — oil, shrimp, and bananas — experienced an unprecedented boom. In 1998, El Niño rains caused an estimated \$2.6 billion worth of crop damage; white spot disease hit the shrimp industry; and oil prices plunged. These problems were exacerbated by the scarcity of credit available following the East Asian, Russian, and Brazilian financial crises. Massive exchange rate depreciation and declining GDP meant that the government could no longer afford to bail out private investors or failing banks incapable of repaying their dollar-denominated debts. By late 1999, the public debt to GDP ratio was over 100% and the Mahuad administration was faced with a full-scale economic, political, and social crisis.⁸

⁷ "IAHCR Analyzes Human Rights Situation in Ecuador," Press Release. March 11, 2005. Available at [<http://www.cidh.org/Comunicados/English/2005/8.05.htm>]

⁸ Paul Beckerman and Andrés Solimano, *Crisis and Dollarization in Ecuador*, Washington: The World Bank, 2002.

In a last ditch effort to stop hyperinflation and prevent a complete currency collapse, then-president Mahuad abandoned the country's domestic currency in favor of the U.S. dollar. 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. However, rather than agreeing to a renewal of a stand-by agreement with the IMF, which would have required privatizing public utilities, Noboa responded to popular demands for increased government spending.

President Gutierrez began his administration by appointing a pro-market finance minister who was able to help him secure the \$205 million IMF stand-by agreement that had eluded the Noboa administration. 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 that culminated in the resignation of Mauricio Pozo, the economy minister, in June 2004. Although the economy grew some 6.3% in 2004 as a result of high oil prices, remittance flows, and a weak U.S. dollar, which has made its exports more competitive, a lack of fiscal discipline has postponed the renewal of a new IMF stand-by agreement. Ecuador's sovereign bonds have been identified as the riskiest investment in South America.⁹ According to Ecuadorian government officials, the country received only 10% of the \$500 million in multilateral loans that had been budgeted for 2005.¹⁰ The Palacio government has sought financial support from Venezuela to cover some of its budget shortfall.

Relations with the United States

Ecuador's relations with the United States are generally good, although the limited U.S. assistance Ecuador has received in comparison to other Andean nations has 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. The Bush Administration is likely to restart stalled negotiations with Ecuador and Colombia for an Andean Free Trade Agreement. A free trade agreement was reached between the United States and Peru in November 2005.¹¹ The U.S. government is concerned about Ecuador's high level of corruption, endemic poverty, chronic political instability, and burdensome foreign debt. Ecuador is also among the largest sources of illegal immigrants to the United States in South America.

Counter-Narcotics Cooperation. Ecuador, a major transport country for cocaine and heroin, has worked closely with the United States in its counter-narcotics

⁹ "Ecuador: Growing Populism Hurts Investment," *Energy Compass*, August 5, 2005.

¹⁰ "Ecuador Min: Only 10% of Multilateral Loans Received," *Dow Jones International News*, December 27, 2005.

¹¹ See CRS Report RL32770, *Andean-U.S. Free Trade Agreement Negotiations*, by Lenore Sek and M. Angeles Villarreal.

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 the Pacific Coast. Since that time, U.S. detection and monitoring operations have seized more than 250 tons of cocaine. In 2004, Ecuador issued a new national drug strategy and has increased the number of police and military posted along its northern border with Colombia. Border security has become a contentious topic between Ecuador, concerned about Colombia's ongoing aerial fumigation, and Colombia, angered by the Ecuadorian government's refusal to label the Revolutionary Armed Forces of Colombia (FARC) a terrorist group.¹² Ecuador received an estimated \$25.8 million in U.S. counter narcotics assistance for FY2005, and \$20 million has been requested in FY2006 as part of the Andean Counterdrug Initiative.

U.S. Aid. The United States is the largest bilateral donor in Ecuador, allocating an estimated \$42 million in total assistance to Ecuador in FY2005 and \$52 million in FY2006. Four USAID goals for Ecuador are the bolstering of democracy, poverty reduction, environmental protection, and border security. 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. Although a majority of U.S. assistance was reprogrammed through non-governmental organizations, this decision, combined with Nethercutt restrictions, cost the Ecuadorian government some \$1.2 million in Economic Support Funds (ESF) and \$1.3 million in military aid in FY2005 and is likely to result in similar losses in FY2006.

Trade. The United States is Ecuador's main trading partner. The United States exported \$1.7 billion in goods to Ecuador in 2004, with machinery, plastics, and paper products the leading items. The United States imported \$4.2 billion in Ecuadorian goods, primarily oil, bananas, and shrimp. Petroecuador, the state-owned oil company, accounts for 55% of the country's oil production and is not slated for privatization. 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 petroleum 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, signed into law by President Bush on August 6, 2002 (P.L. 107-210, H.R. 3009). The law extended the preferential trade program until December 31, 2006, and expanded it to include several additional categories of exports of importance to Ecuador, such as certain textiles, petroleum, and pouched tuna. Ecuador and Colombia withdrew from negotiations for a U.S.- Andean Free Trade Agreement in November 2005 but are likely to resume negotiations early this year. Lingering concerns about several unresolved trade disputes involving U.S. companies and the government of Ecuador could threaten support for the Andean FTA.

¹² "Ecuador-Colombia: Row Over 'Terrorist' Label for FARC," *Latin News Weekly Report*, September 6, 2005.