Order Code RS21687
Updated January 16, 2008

CRS Report for Congress

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

Clare Ribando Seelke
Analyst in Latin American Affairs
Foreign Affairs, Defense, and Trade Division

Summary

Ecuador, a small, oil-producing country in the Andean region of South America, has experienced ten years of political and economic instability. On January 15, 2007, Rafael Correa, a left-leaning, U.S.-trained economist, was inaugurated to a four-year presidential term, becoming the country's eighth president in ten years. President Correa has fulfilled his campaign pledge to call a constituent assembly to reform the country's constitution. On April 15, 2007, 82% of Ecuadorians voted in favor of convoking a constituent assembly with the power to dismiss currently elected officials, despite protests from the opposition-led congress. The assembly, which is controlled by representatives from Correa's party, convened in late November 2007 and now has eight months to draft a new constitution. Ecuador has traditionally had close ties with the United States, although recent trade disputes have strained bilateral relations. U.S. officials have expressed concerns about Correa's ties with Hugo Chávez of Venezuela and his stated policies regarding trade, energy, and counternarcotics matters. Despite those concerns, Congress enacted legislation in June 2007 to extend U.S. trade preferences for Ecuador through February 2008. Early in its second session, the 110th Congress may consider whether to extend those trade benefits. See CRS Report RS22548, *ATPA Renewal: Background and Issues.* This report will be updated.

Background

Slightly smaller than Nevada, Ecuador has a population of 13.8 million people. Since independence from Spain in 1830, Ecuador has 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 two major drug- producing countries (Colombia and Peru) increases its strategic importance to the United States. In 2006, Ecuador was the 9th 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: 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.[1]

Political Context

Ecuador was once considered a relatively stable country, at least in comparison to its Andean neighbors. 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 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. Ecuadorians rejected Gutierrez's attempt to replace judges on the country's three highest courts with his political allies, a move that was also sharply criticized by the international community.[2]

There are historical antecedents for the instability that has recently 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 (similar to Correa). 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 presidents to complete their terms.

Rafael Correa. Rafael Correa, a left-leaning, U.S.-trained economist, was inaugurated to a four-year presidential term on January 15, 2007. Correa defeated Alvaro Noboa, a wealthy banana magnate, in a run-off election held in November 2006. Contrary to analysts' predictions, Correa won the election decisively with 57% of the vote as compared to Noboa's 43%, as voters appeared to embrace his campaign pledge to enact dramatic political reform.[3] Correa succeeded Alfredo Palacio who had served as president since taking over for Lucio Gutierrez in April 2005.

President Correa has moved to fulfill his campaign pledge to reform Ecuador, a country whose economy is currently expanding because of high oil prices, but whose

---

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

[2] International Crisis Group (ICG), "Ecuador: Overcoming Instability?" August 7, 2007.

[3] Catherine M. Conaghan, "Ecuador's Gamble: Can Correa Govern?" *Current History*, February 2007.

political institutions are extremely fragile. On April 15, 2007, 82% of Ecuadorians voted to convene a constituent assembly with the power to rewrite the country's constitution and dismiss its current elected officials, despite protests from the opposition-led congress. Some have questioned the legality of the events leading up to the referendum, which culminated in Ecuador's electoral court expelling (with Correa's backing) 57 legislators who had opposed giving the constituent assembly power to dissolve the congress.[4]

Many analysts had predicted that Correa would have a difficult time enacting his agenda given that his party lacks representation in the Ecuadorian congress, but that has changed as a result of the constituent assembly process. With the traditional parties in disarray, Correa's newly-formed "Alianza Pais" (Country Alliance) party captured 80 of 130 seats in the September 2007 constituent assembly elections. Convened on November 29, the assembly immediately closed the Ecuadorian congress and has since assumed its legislative functions. On January 8, 2008, Ecuador's constitutional court ruled that the assembly's decisions may not be challenged. Some fear that Correa will manipulate the assembly process to his favor, but others predict that his ability to consolidate power in the presidency may be constrained by a lack of oil revenue and by a resurgent opposition.[5]

Corruption. According to Transparency International's 2007 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 that perception. It appears that corruption has continued during the Correa government. In July 2007, Correa dismissed his finance minister after he was accused of trying to manipulate foreign investors about the value of Ecuadorian bonds.[6]

Human Rights. The State Department Human Rights report on Ecuador covering 2006 states that "while the government generally respected the human rights of its citizens, there continued to be serious problems." Those problems include the abuse and unlawful killing of suspects and prisoners by security forces, as well as poor prison conditions. Afro-Ecuadorians reportedly face both official discrimination and negative stereotyping and are stopped by police for document checks more frequently than other citizens. The 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 and 2007 reports.

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, underrepresented 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

---

[4] Mary Anastasia O'Grady, "Sharp Left Turn in Ecuador," *Wall Street Journal*, April 9, 2007.

[5] "Opening Moves by Ecuador's Constituent Assembly Draw Criticism,"*AP*, November 30, 2007.

[6] "Ecuador: New Face, Old Policy," *Economist Intelligence Unit (EIU)*, August 6, 2007.

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

Ecuador has a weak and poorly regulated economy that is overly dependent on a few export commodities (oil, bananas, and shrimp) with volatile prices. 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. As a result, Ecuador suffered a disastrous economic crisis in 1999-2000, the country's worst in more than seventy years, characterized by numerous bank failures, hyperinflation, double-digit unemployment and an eventual currency collapse. 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 has helped curbed inflation in Ecuador and restored some macroeconomic stability to the country, but limited the government's room to conduct an independent monetary policy.[7]

Ecuador's conversion to dollarization has not been accompanied by much-needed structural reforms to diversify the economy, restrict public spending, and increase productivity and investment. In 2003, the Gutierrez government attempted to restrict 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. For the last several years, investors have been concerned by the Ecuadorian government's lack of fiscal discipline during a time of strong oil revenue growth. They were also concerned by many of the economic views expressed by Rafael Correa during his presidential campaign, particularly his failure to rule out the possibility of an "Argentina-style" default on Ecuador's $11 billion debt. Since taking office, President Correa has cut Ecuador's ties with the IMF and expelled a World Bank envoy from the country. He also seeks to increase state control over foreign oil and mining companies.[8]

Energy Industry. Oil exports are extremely important to Ecuador's economy, accounting for more than 50% of exports. High oil prices fueled GDP growth of 4.2% in 2006, but declining production levels resulted in growth of only about 1.5% in 2007. President Correa supports the prior government's May 2006 termination of its contract with the U.S. firm Occidental Petroleum (Oxy) over an alleged breach of contract, a controversial move which is currently in dispute settlement. In April 2007, Correa signed a petroleum cooperation agreement with President Chávez of Venezuela. In October 2007, he issued a decree increasing the Ecuadorian state's share of windfall oil revenues

---

[7] Paul Beckerman and Andrés Solimano, *Crisis and Dollarization in Ecuador*, Washington, D.C.: World Bank, 2002; ICG, 2007.

[8] "Investors Wary of Ecuador's President-Elect," *Financial Times*, January 3, 2007; "Ecuador: Deteriorating Climate," *EIU – Business Latin America*, December 10, 2007.

from 50% to 99%.[9] Private companies have long experienced problems investing in the Ecuadorian oil industry, stemming from the country's chronic instability and tendency for conflicts with private producers. 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. Petroecuador reports losing some $200 million per year in production due to protests and other community-related problems.[10]

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.

U.S. officials have expressed concerns about Correa's populist tendencies, his ties with Hugo Chávez of Venezuela, and his state-centered economic policies. 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 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, such as maintaining U.S. trade preferences for Ecuador Others are more skeptical, questioning why the U.S. should extend trade benefits for a country that has taken hostile actions against U.S. companies, failed to renew a reciprocal investment treaty, and refused to negotiate a free trade agreement.[11]

Counter-Narcotics Cooperation. Ecuador, a major transport country for cocaine and heroin, has worked closely with the United States in its counter-narcotics efforts, but positions taken by the Correa government may not bode well for the future of U.S.-Ecuadorian counternarcotics cooperation.. 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, for U.S. aerial counter-drug detection and monitoring operations. President Correa has confirmed that his government will not renew the lease on the U.S. air base at Manta when it expires in 2009. He has also expressed reservations about any Ecuadorian involvement in Plan Colombia and publicly opposed the Colombian army's incursions into Ecuadorian territory and the

---

[9] "Ecuador Tax Proposal Could Lower 99% Oil 'Windfall' Take," *Platts Commodity News*, December 27, 2007.

[10] "Tightening his Grip," *Economist*, April 21, 2007. "DJ Petroecuador Ex-President: Company Faces Deep Financial Crisis," *Dow Jones Commodities Service*, February 10, 2006; "Oil Sector Protests Become Norm in Ecuador,"*Platts Oilgram Price Report*, March 26, 2007.

[11] "Correa's Triumph," *Financial Times*, November 28, 2006; "Andean Trade Reprieve," *EIU-Business Latin America*, July 9, 2007; "One-Way Trade for Ecuador?" *Investor's Business Daily*, June 22, 2007.

Colombian government's aerial fumigation along the Ecuador-Colombian border. The State Department's Narcotics Control Strategy Report on Ecuador covering 2006 reports mixed results, with cocaine seizures down, but heroin seizures up from 2005 levels.

U.S. Aid. The United States is the largest bilateral donor in Ecuador. Four USAID goals for Ecuador are bolstering democracy, reducing poverty, protecting the environment, and securing the northern border with Colombia. Ecuador received $29.6 million in aid in FY2006, including $19.8 million in counternarcotics assistance through the Andean Counterdrug Initiative (ACI). In FY2007, Ecuador received roughly $32 million in U.S. aid, including $17.3 million in ACI funding. The FY2008 request for Ecuador was for $20.5 million, with only $13 million in counternarcotics assistance.[12] The Consolidated Appropriations Act for FY2008 (H.R. 2764/P.L. 110-161) stipulates that funding from the Development Assistance and Global Health and Child Survival (formerly Child Survival and Health) accounts be made available for Ecuador at no less than the amount allocated in FY2007. The joint explanatory statement to the act recommends providing $13 million in counternarcotics assistance to Ecuador in FY2008.

Trade. The United States is Ecuador's main trading partner, with some 45% of Ecuadorian exports going to the United States. Machinery and plastics are the leading U.S. exports to Ecuador, while oil, bananas, and shrimp account for the bulk of U.S. imports from Ecuador. Since joining the World Trade Organization (WTO) in 1996, Ecuador has lowered its average tariff rate from 30% to 13%, but a number of nontariff trade barriers impede U.S. access to the Ecuadorian market.

Since 1992, Ecuador, along with Peru, Colombia, and Bolivia, has been a beneficiary of the Andean Trade Preference Act (ATPA), which provides trade preferences for Andean countries in exchange for counternarcotics cooperation. Although oil continues to dominate Ecuador's export market, other goods, such as seafood and cut flowers, have benefitted from the program. The ATPA was reauthorized and expanded by the Andean Trade Promotion and Drug Eradication Act (ATPDEA), Title XXXI of the Trade Act of 2002, (P.L. 107-210). ATPDEA extended the preferential trade program until December 31, 2006, and expanded benefits to include certain textiles, petroleum, and pouched tuna. Ecuadorian officials estimate that some $5.6 billion in U.S. trade and 350,000 jobs could be lost without ATPDEA.[13]

While Colombia and Peru have concluded free trade agreements (FTAs) with the United States, Bolivia and Ecuador oppose completing negotiations for FTAs with the United States and are not willing to restart negotiations as a condition to continue receiving U.S. trade preferences under the ATPDEA. Some Members of Congress favor continuing ATPDEA benefits regardless of a country's position on FTAs, while others oppose extending benefits for Bolivia and Ecuador. Failing to resolve those differences, Congress has settled on short extensions of ATPDEA benefits. The most recent extension will expire on February 29, 2008.

crsphpgw

---

[12] Beginning in FY2008, alternative development programs previously supported by Andean Counterdrug Initiative funds have shifted to the Economic Support Fund (ESF) account.

[13] "Andean Trade Reprieve," *EIU-Business Latin America*, July 9, 2007. See CRS Report RS22548, *ATPA Renewal: Background and Issues*, by M. Angeles Villarreal.