



## CRS Report for Congress

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

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### 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. The assembly, which is controlled by representatives from Correa's party, has until the end of July 2008 to draft a new constitution. Many Ecuadorians approved of Correa's condemnation of Colombia's unauthorized March 2008 raid of a Revolutionary Armed Forces of Colombia (FARC) camp in Ecuador. They also support his decision not to renew the current U.S. lease on the air force base at Manta when it expires in 2009, a decision which has strained U.S.-Ecuadorian relations. U.S. officials have expressed concerns about President Correa's ties with Hugo Chávez of Venezuela and his stated policies on trade and energy matters. Despite those concerns, Congress enacted legislation in February 2008 to extend U.S. trade preferences for Ecuador through December 2008. For more information, 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. Ecuador is both geographically and ethnically diverse, and has a relatively long, albeit unstable, experience with democratic rule. Some 40% of Ecuadorians live in poverty and another 13% live in extreme poverty.<sup>1</sup>

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<sup>1</sup> United Nations Economic Commission for Latin America and the Caribbean, *Social Panorama* (continued...)

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## 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.<sup>2</sup>

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 corruption proliferated. 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 has led to inconsistent economic and political policies from one administration to the next, and to the inability of presidents to complete their terms.

## The Correa Presidency

Rafael Correa, a left-leaning, U.S.-trained economist, was inaugurated to a four-year term as President of Ecuador on January 15, 2007. When Correa created his own coalition and decided to run for president in 2006, few analysts predicted that he would be competitive in a field of well-known candidates that included Alvaro Noboa, Ecuador's richest man. Most analysts were surprised by his second place finish in the first round of voting held in October 2006. Contrary to many analysts' predictions, Correa won the November run-off election with 57% of the vote as compared to Noboa's 43%. Some observers maintain that voters embraced his campaign pledge to enact dramatic political reform.<sup>3</sup> Correa succeeded Alfredo Palacio who had served as president since taking over for Lucio Gutierrez in April 2005. His only previous government experience was a four-month stint as Palacio's finance minister in 2005.

Sixteen months into his four-year term, President Correa continues to enjoy high approval ratings. Those ratings have been boosted by his efforts to reform the country's

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<sup>1</sup> (...continued)  
of *Latin America*, 2007.

<sup>2</sup> International Crisis Group (ICG), "Ecuador: Overcoming Instability?" August 7, 2007.

<sup>3</sup> Catherine M. Conaghan, "Ecuador's Gamble: Can Correa Govern?" *Current History*, February 2007.

political system, increase social spending, and reassert government control over Ecuador's economy and territory. Many Ecuadorians approved of Correa's condemnation of Colombia's unauthorized March 2008 raid of a FARC guerrilla camp in Ecuador. They also support his decision not to renew the current U.S. lease on the air force base at Manta when it expires in 2009, a decision which has caused strain in U.S.-Ecuadorian relations. Correa's populist policies have concerned many analysts and foreign investors. Foreign direct investment in Ecuador fell from an estimated \$270.7 million in 2006 to roughly \$179 million in 2007.<sup>4</sup>

**Constituent Assembly.** President Correa is fulfilling his campaign pledge to carry out constitutional reform. On April 15, 2007, 82% of Ecuadorians approved a referendum 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.<sup>5</sup>

Elections for the new Constituent Assembly were held in September 2007. With the traditional parties in disarray, Correa's newly-formed "Alianza Pais" (Country Alliance) party captured 80 of 130 seats in the constituent assembly elections. Convened on November 29, the assembly immediately closed the Ecuadorian Congress and assumed its legislative functions. On January 8, 2008, Ecuador's Constitutional Court ruled that the assembly's decisions may not be challenged. The assembly spent the first three months of its mandate passing legislation, including a major tax reform package, before turning to constitutional debates in March. Progress since that time has been slow, with the assembly getting bogged down in debates about how and whether to reform constitutional clauses on abortion, religion, and gay rights. The assembly recently voted to extend its mandate until July 2008. Some fear that Correa may be using his continued popularity to unduly manipulate the assembly process to his favor.<sup>6</sup>

**Energy Policy.** Oil is extremely important to Ecuador's economy, accounting for more than 50% of exports. High oil prices fueled an economic growth rate of 4.2% in 2006, but declining production levels resulted in growth of only about 1.5% in 2007. 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. In recent years, Petroecuador has lost some \$200 million annually in production due to protests and other community-related problems.<sup>7</sup>

President Correa is seeking to increase state control over the energy sector. In October 2007, he issued a decree that increased the Ecuadorian state's share of windfall

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<sup>4</sup> Alonso Soto, "Ecuador Foreign Investment Tumbles, Outlook Murky," *Reuters*, April 24, 2008.

<sup>5</sup> Mary Anastasia O'Grady, "Sharp Left Turn in Ecuador," *Wall Street Journal*, April 9, 2007.

<sup>6</sup> "Country Report: Ecuador," *Economist Intelligence Unit (EIU)*, May 2008; "Going Nowhere," *Economist*, May 10, 2008.

<sup>7</sup> "Oil Sector Protests Become Norm in Ecuador," *Platts Oilgram Price Report*, March 26, 2007; "Ecuador Says State Oil Company in Crisis," *EFE*, November 29, 2007.

oil revenues from 50% to 99%, unless companies were willing to switch from production sharing agreements to new service contracts controlled by Petroecuador. Five foreign oil companies entered into negotiations with the Ecuadorian government and were about to agree to switch to service contracts within a two-year period when President Correa shortened the proposed transition period to just six months. Most companies have yet to respond to the revised position of the Ecuadorian government.<sup>8</sup> 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. President Correa supports the prior government's 2006 termination of its contract with the U.S. firm Occidental Petroleum (Oxy) over an alleged breach of contract, a controversial move that is currently in dispute settlement. In November 2007, the Ecuadorian government initiated new legal proceedings against Occidental and City Oriente, another U.S.-owned oil company, for allegedly failing to pay their windfall oil taxes.

**Ecuador-Colombia-Venezuela Border Crisis.** On March 1, 2008, the Colombian military bombed a FARC camp in Ecuador, killing at least 25 people, among them, Raúl Reyes, the terrorist group's second highest commander. In a subsequent raid on the camp, Colombian forces captured laptop computers, which Interpol has verified as belonging to Reyes.<sup>9</sup> Files in those laptops allege that the government of Hugo Chávez of Venezuela was planning to provide millions of dollars in assistance to the FARC for weapons purchases and that President Correa received campaign donations from the FARC in 2006. Both Chávez and Correa vigorously reject these claims.<sup>10</sup>

Colombia's unauthorized incursion caused a major diplomatic crisis between Colombia, Ecuador and Venezuela. President Correa responded to the raid by breaking diplomatic ties with Colombia and sending additional troops to the Ecuador-Colombia border. In a show of solidarity with Ecuador, President Chávez broke ties with Colombia and sent troops to Venezuela's border with Colombia. Some feared that the Ecuador-Colombia-Venezuela crisis might escalate into a military conflict, but those concerns were allayed after a Rio Group summit held in the Dominican Republic on March 7.<sup>11</sup> At the Rio summit, President Uribe publicly apologized for the incursion and vowed that it would never happen again. President Chávez appeared to accept the apology and called for an end to the crisis, but President Correa remained angered by the incident. The Rio Group issued a resolution that rejected Colombia's incursion of Ecuadorian territory, but acknowledged Uribe's apology.<sup>12</sup>

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<sup>8</sup> "Ecuador: Contract Conflicts," *EIU Business Latin America*, May 5, 2008.

<sup>9</sup> Simon Romero, "Files Released by Colombia Point to Venezuelan Bid to Arm Rebels," *New York Times*, March 30, 2008.

<sup>10</sup> "Interpol Confirms Link Between FARC, Chávez," *Miami Herald*, May 15, 2008.

<sup>11</sup> Established in 1986, the Rio Group is an organization composed of the heads of state of the governments of Latin America and the Caribbean.

<sup>12</sup> "How Diplomacy Silenced the Drums of War in Less Than a Week," *Latin American Security and Strategic Review*, March 2008; Francis Robles, "Ecuador Rages, Colombia and Venezuela Make Up," *Latinnews Daily*, March 14, 2008; "Leaders Defuse South American Crisis," *Miami Herald*, March 8, 2008.

The Rio Group summit was followed by a March 17-18 OAS Meeting of Consultation of Ministers of Foreign Affairs in Washington D.C. At that meeting, an OAS mission headed by OAS Secretary General José Miguel Insulza that visited Ecuador and Colombia reported that it found contradictory reports from Colombian and Ecuadorian officials on when and how the raid occurred, but did not attempt to reconcile the discrepancies. On March 18, after extended debate, the OAS adopted a resolution rejecting, but not condemning, the bombing raid and called for the restoration of diplomatic ties between Ecuador and Colombia.<sup>13</sup>

Ecuador has yet to restore diplomatic relations with Colombia, and recent events do not bode well for the immediate future of Ecuador-Colombia relations. When Colombia announced that one of those killed in the raid was an Ecuadorian citizen with possible ties to the FARC, President Correa reacted angrily, and his government asked the OAS to investigate. His defense minister later admitted that Ecuadorian intelligence forces had previously investigated this individual's possible ties to the FARC.<sup>14</sup> Correa later dismissed his pro-U.S. defense minister as well as several other top military officials whom he accused of sharing intelligence with both Colombia and the United States without his approval. President Correa has protested against what he says is a Colombian government media campaign that alleges his government has ties to the FARC. The border crisis may have served to reinforce the pre-existing ties between the Correa government in Ecuador and the Chávez government in Venezuela.

## Relations with the United States

Ecuador's relations with the United States have traditionally been close, although recent events have strained bilateral relations. Although the United States has concluded free trade agreements (FTAs) with Peru and Colombia, negotiations for a bilateral free trade agreement with Ecuador have been suspended indefinitely in the wake of the dispute with the U.S. firm Occidental Petroleum. 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 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 United States should keep extending trade benefits for a country that has taken hostile actions against U.S. companies and has refused to negotiate a free trade agreement.

Ecuador, a major transport country for cocaine and heroin, has worked closely with the United States on 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.

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<sup>13</sup> Report of the Organization of American States (OAS) Commission That Visited Ecuador and Colombia, Washington D.C., March 17, 2008; Resolution of the Twenty-Fifth Meeting of Consultation of Ministers of Foreign Affairs, Washington D.C., March 17, 2008.

<sup>14</sup> Jeanneth Valdivieso, "Ecuador: FARC Raid Death Harms Relations," *Associated Press*, March 24, 2008; "Slain Ecuadorian Linked to FARC," *Latinnews Daily*, March 28, 2008.

The United States reportedly spent some \$60 million to build those FOL facilities. 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. Some press reports indicate that the United States may be considering trying to relocate its counterdrug facilities to a location in Peru or Colombia.<sup>15</sup> President Correa has also expressed reservations about any Ecuadorian involvement in Plan Colombia and publicly opposed the Colombian army's incursions into Ecuadorian territory.

**U.S. Aid.** The United States is the largest bilateral donor in Ecuador. Principal goals for U.S. assistance to Ecuador are bolstering democracy, reducing poverty, protecting the environment, and securing the northern border with Colombia. Ecuador received \$25.2 million in aid in FY2007, including \$17.3 million in counternarcotics assistance. In FY2008, Ecuador received roughly \$32 million in U.S. aid, including \$9.1 million in counternarcotics assistance. The FY2009 request for Ecuador was for \$32.5 million, with \$13.4 million in counternarcotics assistance.

**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. Congress has approved short term extensions of ATPDEA benefits, with the most recent extension scheduled to expire on December 31, 2008. Ecuadorian officials estimate that some \$5.6 billion in U.S. trade and 350,000 jobs could be lost without ATPDEA.<sup>16</sup>

While Colombia and Peru have concluded free trade agreements (FTAs) with the United States, the Ecuadorian government opposes completing negotiations for an FTA with the United States and is 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.

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<sup>15</sup> Simon Romero, "Ecuador's Leader Purges Military and Moves to Expel American Base," *New York Times*, April 21, 2008.

<sup>16</sup> "Andean Trade Reprieve," *EIU-Business Latin America*, July 9, 2007. See CRS Report RS22548, *ATPA Renewal: Background and Issues*, by M. Angeles Villarreal.