

# CRS Report for Congress

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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 of the Patriotic Society Party (PSP) was removed from office by Ecuador's Congress following weeks of popular protests. The protests were not led by an organized opposition movement, nor were they motivated by an economic crisis. Instead, Ecuadorians rejected Gutierrez's December 2004 replacement of the majority of the judges on the country's three highest courts with his political allies, an illegal move that had been sharply criticized by the international community. They expressed extreme mistrust of Gutierrez, and a generalized frustration with the country's ruling political class. Gutierrez, a former army Colonel who was part of the junta that toppled the government of Jamil Mahuad in January 2000, has sought asylum in Brazil. Succeeding him as President is his former vice president, Alfredo Palacios, a physician and political independent. Palacios is the country's seventh president in nine years. Ecuador's economy is strong, but its political institutions are in ruins. President Palacios will have to oversee the selection of new constitutional and electoral courts, which were dissolved on April 27, 2005. He aims to work closely with the United States, especially on military and counter-narcotics matters, but has yet to express whether or not Ecuador will continue negotiating for a U.S.- Andean Free Trade Agreement. 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, makes it of strategic importance to the United States. Ecuador is the 12<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: 55% mestizo (mixed Indian and Spanish descent), 25% indigenous, 10% Caucasian, and 10% African. Some 56% of the population and more

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than 80% of indigenous Ecuadorians live in poverty.<sup>1</sup> 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, and political fragmentation, in addition to the difficulty of balancing 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. Abdala Bucaram was removed from office constitutionally in 1997, after being declared mentally unfit by the National Congress and allegedly misappropriating \$90 million worth of public funds. Jamil Mahuad was ousted by a coup in 2000, after a prolonged economic crisis.

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 (cash transfers sent from citizens living abroad), 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 delay or inhibit the success of policy initiatives and failed to shield the country from external shocks.<sup>2</sup>

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<sup>1</sup> "Ecuador: Indigenous Groups Break with President," *NACLA Report on the Americas*, New York: Mar/Apr 2003; Suhas Parendeka, Rob Vox, and Donald Winkler, "Ecuador: Crisis, Poverty and Social Protection," in *Crisis and Dollarization in Ecuador: Stability, Growth and Social Equity*, Paul Beckerman and Andrés Solimano, eds.. Washington: The World Bank.

<sup>2</sup> Mejia-Acosta, Andres, Caridid Araujo, Anibal Perez Linan, Sebastian M. Saiegh, and Simon Pachano. "Political Institutions, Policymaking Processes, and Policy Outcomes in Ecuador," FLACSO-Inter-American Development Bank, August 2004.

**The 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 limited, however, by opposition parties that dominated the Congress, indigenous protests, and allegations of corruption. Despite his party's poor performance in the October 17, 2004 municipal elections, President Gutierrez was able to stave off impeachment proceedings in November 2004 by forming an alliance with Bucaram's Roldodista Party (PRE) and Alvaro Noboa's National Action Institutional Renewal Party (PRIAN). In December 2004, Gutierrez used that support to pack three of the country's highest courts with political allies. Gutierrez garnered the PRE's backing for his government by guaranteeing that corruption charges against Bucaram would be dropped and that he would then be free to return to Ecuador, which he did on April 2, 2005. Gutierrez's move was denounced by the United Nations and the Inter-American Commission of Human Rights (IAHCR) among others.<sup>3</sup> Most analysts have identified this attempt to subvert the rule of law as the action that precipitated Gutierrez's ouster. The Bush Administration and the Organization of American States (OAS), though opposed to Gutierrez's recent actions, have expressed some concerns about the constitutionality of his removal and replacement.<sup>4</sup>

**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, Sierra Leone, and Uganda. In 2003, a series of arms trafficking scandals threatened to undermine the generally positive reputation of one of the country's most respected political institutions, the Ecuadorian military.<sup>5</sup> 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.<sup>6</sup>

**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 recently expressed concerns about the fragility of the rule of law in Ecuador, and the escalating violence there against union and indigenous leaders.<sup>7</sup> Although the Constitution prohibits trafficking in persons, there are no penal laws to enforce that prohibition. A 2002 International Labor Organization (ILO) report found that some 5,200 Ecuadorian children were internally trafficked for prostitution. In June 2004, the U.S. State Department placed Ecuador on the Tier 3 list of

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

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

<sup>5</sup> "Arms Scandal Seen Hurting Ecuador Military's Image," *Reuters*, October 25, 2003.

<sup>6</sup> "Ecuador's Gutierrez Delivers on December Deal: Bucaram is Allowed to Return," *Latin News Weekly Report*, April 5, 2005.

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

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.

**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, which included two cabinet appointments, 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.<sup>8</sup>

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 the electricity and telecommunications industries, Noboa responded to popular demands for increased government spending.

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<sup>8</sup> Beckerman and Solimano, *Crisis and Dollarization in Ecuador*, The World Bank, 2002.

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 (and much needed) IMF stand-by agreement. Ecuador's sovereign bonds have been identified as the riskiest investment in Latin America.<sup>9</sup>

## 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 currently negotiating an Andean Free Trade Agreement with Ecuador, Colombia, and Peru. The U.S. government is concerned about Ecuador's high level of corruption, endemic poverty, weak political system, and burdensome foreign debt. Ecuador is also the largest source of illegal immigrants to the United States in South America. In response to the recent crisis there, Secretary of State Condoleezza Rice has stressed that "the key is that the Ecuadorian people understand that the OAS, the United States, [and] all the members of the OAS support a constitutional path" in Ecuador.<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 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. Ecuador received an estimated \$25.8 million in U.S. assistance for FY2005, and \$20 million has been requested in FY2006 for law enforcement, border security, and alternative development as part of the Andean Counterdrug Initiative (ACI).<sup>11</sup>

**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. The Administration has requested \$52 million in assistance to Ecuador for FY2006. Four USAID goals for Ecuador are the bolstering of democracy, poverty reduction, environmental protection,

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<sup>9</sup> "Long-term Bets on Ecuador Seen Hinging on Reforms," *Reuters News*, September 1, 2004.

<sup>10</sup> "U.S. Participates in Democracy-Strengthening Mission to Ecuador," *U.S. State Department Press Releases*, April 26, 2005.

<sup>11</sup> See CRS Report RL32337, *Andean Counterdrug Initiative (ACI) and Related Funding Programs: FY2005 Assistance*, by Connie Veillette.

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. This decision cost the Ecuadorian government \$13 million in Economic Support Funds (ESF) and \$1.3 million in military aid in FY2005. If Congress again applies the Nethercutt amendment, Ecuador could lose another \$7 million in ESF and \$750,000 in military aid in FY2006.<sup>12</sup>

**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. In the same year, 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. In total, approximately 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. Nine rounds of negotiations for a new free trade agreement (FTA) between Ecuador, Colombia, Peru and the United States have been held since May 2004.<sup>13</sup> In October 2004, the Subcommittee on the Western Hemisphere of the House International Relations Committee held a hearing on unresolved trade disputes involving U.S. companies and the governments of Ecuador and Peru that could threaten support for the Andean FTA. Lingering concerns about those pending disputes were reiterated by the Subcommittee Chairman, Representative Dan Burton, at an April 13, 2005 hearing on U.S. trade agreements with Latin America. At this time, the Palacios government has not expressed whether it will continue negotiations for an Andean FTA.

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<sup>12</sup> The Nethercutt amendment to the FY2005 Consolidated Appropriations Act (H.R. 4818/P.L. 108-447) bars Economic Support Funds (ESF) assistance to countries that have not signed an Article 98 agreement.

<sup>13</sup> For more information on the proposed Andean Free Trade Agreement, see CRS Report RL32770, *Andean-U.S. Free Trade Agreement Negotiations*, by Lenore Sek.