

ECUADOR: OVERCOMING INSTABILITY?

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ECUADOR: OVERCOMING INSTABILITY?

EXECUTIVE SUMMARY

Ecuador has been Latin America's most unstable democracy for a decade. Starting with the ousting of President Abdalá Bucaram by Congress and street protests in 1997, weak, temporary governments have been the rule. In 2000, Jamil Mahuad was toppled by a civilian-military coup, and in 2005, protests brought down Lucio Gutiérrez, who had helped oust Mahuad. The government of Rafael Correa of the Alianza País (AP) movement, who took office in January and enjoys record-high approval ratings, is applying "shock therapy" to overwhelm the discredited opposition and pave the way for a constituent assembly (CA) intended to produce "profound, radical and fast change". This triggered one of the sharpest clashes between branches of government since the return to democracy in 1979, including the Electoral Court's firing of 57 opposition members of Congress in March, accompanied by street violence. To restore stability to the troubled country, Correa will need to pay more attention to upholding the rule of law, ensuring a level CA playing field and building consensus for fundamental reforms.

Chronic instability has been linked to progressive undermining of the rule of law. Veto power of powerful economic groups and the parties in Congress and the judiciary has been strengthened, as has the street power of social movements, in particular indigenous organisations, but lately also sectors of the middle and upper-middle class in large cities, especially Quito. The military retains its behind-the-scenes influence but may be more reluctant to intervene directly than in the past unless collapse of public order is imminent. While the economic and banking crisis of the late 1990s, central to Mahuad's fall, was patched over by introducing the dollar as the official currency in 2000, and economic growth is steady, there are sustainability questions. If oil prices fall, the uncertain investment environment and declining production of state-owned PetroEcuador could bring back economic stagnation. Correa is focused on fighting the opposition and making the CA happen. It is uncertain whether he could build the necessary consensus to steer Ecuador

out of crisis, especially in the face of hostility from the elites.

Instability's roots trace back to the institutional framework established during the return to democracy and the foreign debt accumulated at the start of the oil boom in the 1970s. Since then, lack of stable congressional majorities and the exclusion of important segments of society, in particular the indigenous, have prevented long-term planning, and an effective attack on corruption, patronage politics and rent-seeking attitudes fostered by oil wealth. In 1997-1998, interim President Fabián Alarcón tried to restore governability with a new constitution. He failed, and it is at least questionable whether Correa's plan to introduce sweeping reforms by a new constitution will fare better. History shows Ecuador's problems cannot be solved solely by constitutional engineering and that the intransigent elites and traditional parties will do everything in their power to protect their privileges.

If he is to succeed, Correa will need to:

- ❑ uphold the rule of law and guarantee the separation of powers;
- ❑ prepare the CA election with full transparency and guarantees for the opposition;
- ❑ seek consensus with the opposition on key points of the new constitutional framework to be elaborated by the CA, including economic reforms;
- ❑ advance institutionalisation and democratisation of Alianza País and the social and political movements; and
- ❑ elaborate, with broad citizen participation, an economically viable National Development Plan 2007-2011.

Bogotá/Brussels, 7 August 2007

ECUADOR: OVERCOMING INSTABILITY?

I. INTRODUCTION

President Rafael Correa, who was elected in November 2006 and sworn in on 15 January 2007, has promised to bring “rapid, radical and profound change” to Ecuador. That is undoubtedly needed in a country which during the past decade has been Latin America’s most unstable democracy. Since 1996, it has had eight presidents, three of whom were ousted by Congress and street protest. The rule of law has been progressively weakened and despite extensive reform efforts, such as a new constitution in 1998, the political system has become largely dysfunctional. In addition, Ecuador experienced one of the continent’s worst economic crises, with hyperinflation and the breakdown of its banking sector in 1999.

This background report examines the roots of the instability and the new government’s first steps to bring about far-reaching political and socio-economic change. Correa, a young economist who until briefly economy minister in the Alfredo Palacio administration (2005-2007) was basically a political unknown, came to power with the support of a political movement begun by left-wing intellectuals after President Lucio Gutiérrez was ousted in April 2005. His government sees itself as the avant-garde of a “citizen revolution” promising to bury the ills of the old system. These include the veto power in Congress of traditional parties which, polls indicate, a majority of Ecuadorians see as corrupt, politicisation of key state institutions, including the judiciary and Electoral Court, pervasive social inequality and poverty and the elite’s sell-out to foreign interests. A pledge to hold a constituent assembly (CA) to prepare a new constitution was at the heart of Correa’s campaign; its creation was overwhelmingly endorsed by referendum on 15 April 2007 and is now at the centre of government policy.

Correa’s record-high approval ratings reflect both trust in his administration’s ability to overhaul Ecuador’s institutions and cater to “bread and butter” demands and deep frustration with the incapacity, corruption and unconstitutional behaviour of previous governments and Congress, in particular since the mid-1990s. Starting with the election of Abdalá Bucaram in 1996, things moved from bad to worse.

He was toppled by Congress and street protest after not even a year in office. Two successors, Jamil Mahuad and Lucio Gutiérrez, were also ousted, the first by a civilian-military coup during an economic crisis, the second amid Quito street protests after he took over the Supreme Court in 2004. Ecuador struggled even earlier to make democracy – peacefully resumed in 1979 – work. The absence of stable majorities in Congress contributed to the lack of longer-term policy planning, while insufficient representation of particularly the large indigenous minority prompted growing street opposition.

During his first six months, Correa has faced opposition in Congress, the judiciary, the Electoral Tribunal (TSE) and state institutions. Both sides have resorted to questionable means but the president and his followers have been able to limit their opponents’ room for manoeuvre, extended control into basically all branches of government and moved forward with the CA. Correa has also denounced critical media, which uncovered dubious political deals.

The next step is the election of 130 CA delegates on 30 September. While the campaign officially opens in mid-August, Correa has already begun the effort to ensure a majority for Alianza País, including by generous, if unsustainable, social spending. There are signs, however, that the election may prove more difficult than expected. The battered political opposition has regrouped, and the government has not clearly enunciated either the specific changes it wants in the new constitution or a longer-term political strategy. There is worrying potential for stalemate in the assembly, enfeebled governance and a new round of instability.

II. A HISTORY OF INSTABILITY

A. POLITICS

In 1997, 2000 and 2005, Presidents Abdalá Bucaram, Jamil Mahuad and Lucio Gutiérrez were ousted by Congress amid strong popular protests, and with the acquiescence of the armed forces.¹ While there are historic precedents for such political instability, in particular in the first half of the twentieth century,² Ecuador was also the first of a series of Latin American countries to transition peacefully from military to democratic rule in more recent times.

The transition from the three-member military junta, which took office after toppling General Guillermo Rodríguez in 1976, to the elected government of Jaime Roldós in 1979 is widely acknowledged as a model for peaceful reestablishment of representative government based on a pact between military and civilian elites.³ The two core elements of the pact, based on the Plan for the Juridical Restructuring of the State (*Plan de Reestructuración Jurídica del Estado*), were the 1978 constitution and the law on elections and political parties. The chronic instability that started in the mid-1990s⁴ was preceded by seventeen years of relative stability during which five presidents – Jaime Roldós (1979-1981),⁵ Oswaldo Hurtado (1981-1984), León Febres-Cordero (1984-

1988), Rodrigo Borja (1988-1992) and Sixto Durán (1992-1996) – all completed their terms.⁶

Several factors, political as well as economic, help explain the instability. The 1978 constitution, which institutionalised liberal democracy while keeping a lid on participation in the political process, was elaborated behind closed doors and not received enthusiastically by Ecuadoreans.⁷ Together with the law on elections and political parties, it produced neither satisfactory democratic representation nor stable majorities in Congress.⁸

Failure between 1979 and 1996 to implement administrative and economic reforms and overcome rent-seeking and corruption strengthened by the oil-dependent economy that emerged in the 1970s was in good part due to lack of stable legislative majorities. The traditional parties such as the Social Christian (PSC) and Democratic Left (ID), under a few strongmen (*caudillos*), pursued clientelistic practices. In the 1980s, as social inequality and poverty persisted, the young democracy was challenged first by big worker protests, then by well-organised, indigenous and social movements. Progressively deeper fissures emerged between Quito and the highlands, on the one hand, and the economic powerhouse Guayaquil and the Pacific provinces on the other. The mid-1990s saw the emergence of “anti-system” and populist presidents backed by new political parties⁹ and the military’s re-emergence as political arbiter.

¹ In 1997, the military withdrew support from Bucaram during the demonstrations after Congress charged him with “mental unfitness”. During the January 2000 demonstrations against Mahuad, the military and police refused to enforce order. Alvaro Bello, *Etnicidad y ciudadanía en América Latina. La acción colectiva de los pueblos indígenas* (Santiago de Chile, 2004), p. 153.

² Between 1925 and 1948, Ecuador had 27 administrations. In the 1950s, partly due to banana and cacao booms and subsequent economic development, elected governments finished their terms; but in the 1960s and early 1970s, instability returned. Between 1960 and 1972, only two of seven governments were elected. In 1970, José María Velasco, elected for the fifth time in 1968, proclaimed a dictatorship. He was ousted in 1972, and the military ruled until the transition to democracy.

³ Pablo Andrade, “Democracia liberal e inestabilidad política en Ecuador”, *Oasis*, no. 11 (2005).

⁴ The first clear sign was Congress’s impeachment of Vice-President Alberto Dahik in 1995 for corruption.

⁵ Roldós and his wife died in a plane crash in 1981. Vice-President Hurtado finished the term.

⁶ The Roldós-Hurtado government was centre-left; Febres’s was centre-right, Borja’s social democratic, Durán’s centre-right.

⁷ The 1978 constitution was written by three commissions established by the military junta and approved by a referendum in January 1978. Crisis Group interviews, political analysts, Quito, 8 and 11 June 2007.

⁸ The 1978 constitution and the law on elections and political parties established that only parties could represent the electorate. They had to have a membership representing at least 1.5 per cent of that electorate and a presence in at least ten of the 22 provinces. Alliances were prohibited, and independent candidates and political movements could not participate in the political process. This made it difficult, for example, for indigenous people to obtain adequate representation. Simón Pachano, *La trama de Penélope* (Quito, 2006); Alexandra Vela Puga, “Regulación jurídica de los partidos políticos en Ecuador”, in Daniel Zovatto, *Regulación jurídica de los partidos políticos en América Latina* (Mexico, D.F., 2006), pp. 424-427; “Constitución política de Ecuador”, 15 January 1978.

⁹ The Partido Roldosista Ecuatoriano (PRE), the Partido Renovador Institucional de Acción Nacional (PRIAN), the indigenous Patachutik party, and, more recently, the Partido Sociedad Patriótica (PSP) of Lucio Gutiérrez.

As the rule of law was weakened, unconstitutional actions became common. Starting with the ousting of President Bucaram in 1997, Congress assumed a prominent role in making and breaking governments. Serious economic difficulties, coming to the fore with the boom-bust oil-price cycle and mounting foreign debt since the early 1980s, the breakdown of the banking sector and hyperinflation in the late 1990s, and government plans to adopt the dollar as the official currency contributed to the crisis.¹⁰

In 1996, Bucaram of the populist Ecuadorian Roldosista party (PRE) won the second round of the presidential elections with 54.4 per cent of the vote against Jaime Nebot of the PSC.¹¹ In the first round, he projected himself as the anti-establishment candidate, appealing above all to the poor and social movements as a catalyst for change. Despite a strong presence in the coastal provinces,¹² his party lacked national reach, forcing him to seek allies in the run-off. These included the indigenous movement,¹³ to which he promised a constituent assembly and creation of a ministry for indigenous affairs in order to express the multiethnic nature of the Ecuadorian nation.¹⁴

In power, however, Bucaram's efforts to conciliate two of his harshest critics, former President and Guayaquil Mayor Leon Febres-Cordero (PSC) and Quito Mayor Jamil Mahuad (Unión Demócrata Cristiana, or UDC), failed.¹⁵ His economic policy, which aimed at pegging the sucre to the dollar and introducing fiscal austerity through reduction of state

subsidies and privatisation of state-owned enterprises, did not sit well with the labour unions and the middle class.¹⁶ The Confederation of Ecuador's Indigenous Nationalities (CONAIE) opposed his neoliberal platform and was further estranged by the creation of a ministry of ethnicity and culture, whose senior officials represented only a limited sector of the indigenous movement.¹⁷ The establishment resented his constant verbal attacks on the "oligarchy" and outlandish public appearances.¹⁸ His appointments of members of his extended family and cronies to government posts were criticised, and corruption charges abounded.¹⁹

In January 1997, CONAIE formed the indigenous, trade unions and peasant and women groups into the Patriotic Front (Frente Patriótico).²⁰ During a large protest march in Quito on 29 January, calls for economic policy change turned into a cry for Bucaram's resignation. The dominant parties in Congress – PCS and UDC – backed the 3 February national strike called for by the Front and its demands. Instead of impeaching Bucaram, Congress resolved to remove him by simple majority vote on grounds of "mental unfitness".²¹ The armed forces declared themselves "neutral", thereby

¹⁰ Political-institutional instability continued during the presidency of Lucio Gutiérrez in spite of economic stabilisation following introduction of the dollar as national currency. See Section II.B below.

¹¹ The PRE emerged in 1983 as a spin-off of President Jaime Roldos's Concentración de Fuerzas Populares (CFP) party. In 1988, it obtained 16.3 per cent of seats in Congress. In 1992 it fell back slightly to 16 per cent but then obtained 23.2 per cent in 1996. *La trama de Penélope*, op. cit., p. 130.

¹² In 1996, the PRE obtained only 8 per cent of its votes in the Andean province of Pichincha, but 35 per cent in Guayas province. *Ibid*, p. 169.

¹³ CONAIE, the umbrella organisation of indigenous movements, was started in 1986, the indigenous Pachakutik party in 1996.

¹⁴ "Acta del acuerdo entre las organizaciones indígenas - CONAIE, FEINE, FENACLE- y el binomio presidencial Abdalá Bucaram-Rosalía Arteaga", Quito, 2 July 1996.

¹⁵ On 5 September 1996, Bucaram told Mahuad he would support his initiative to build a trolley-bus public transport system in Quito. The next day he met with Febres-Cordero, whom he had ridiculed during his campaign, to discuss Guayaquil's problems. Alberto Acosta, "Ecuador. El Bucaranismo en el Poder", *Revista Nueva Sociedad*, no. 188, (1996), p. 13.

¹⁶ Bucaram's popularity decreased from 69 per cent at the beginning of his term to 15 per cent in January 1997. "Opinion pública y realidad nacional: 25 años, problemas que preocupan a la población", CEDATOS, *Ecuador Debate*, N° 46 (1999).

¹⁷ The nomination as indigenous affairs minister of the CONAIE vice president, Luis Pandam, from the Amazonia, kindled internal tensions between indigenous people from Amazonia and those from the Andes. However, they united soon against Bucaram. *Etnicidad y ciudadanía en América Latina*, op. cit., pp. 153-154; José Sánchez-Parga, *El Movimiento indígena ecuatoriano* (Quito, 2007), pp. 148-149.

¹⁸ During the campaign Bucaram alluded to the PSC as "choros", a common word for "thieves". On 14 August 1996, two days after he was sworn in, he referred to former President Rodrigo Borja as a "dunce". On 9 October he released a CD titled "*El Loco que Ama*" ("The Crazy Man who Loves"), accompanied by Los Iracundos, a Uruguayan rock band. On 16 December, he sang and danced in a televised public benefit. Donations collected during the event were allegedly mismanaged.

¹⁹ Notable corruption scandals include: overpricing of Ecuapower stock in its privatisation for more than \$63 million, over \$61 million in customs tax evaded and the "mochila escolar case", which reduced the education budget by over \$40 million.

²⁰ The Patriotic Front was formed by the Coordinadora de Movimientos Sociales, the Frente de Nacionalidades Indígenas y Organizaciones Campesinas, the Coordinadora Política de Mujeres, the Frente Ecuatoriano de Derechos Humanos, the Frente Unitario de Trabajadores and the Frente Popular.

²¹ This was done by bending Article 100 of the constitution.

giving a green light to dismiss him on questionable constitutional grounds.²²

Equally questionable was Congress' appointment of its president, Fabian Alarcón,²³ as interim head of state on 11 February.²⁴ With Congress in control, Alarcón, who was enmeshed in a corruption scandal,²⁵ had little room for manoeuvre. During his eighteen-month term, he established an anti-corruption commission and brought about reform of the party law (*ley de partidos*). In May 1997, he called for a referendum to ratify his interim mandate and establishment of a constituent assembly.²⁶ The 70 assembly delegates were elected on 30 November 1997²⁷ and finished the new constitution on 5 June 1998. It came into force automatically when Mahuad was sworn in as president two months later.²⁸

The election of Mahuad, who had served twice as mayor of Quito and was widely considered a talented manager,²⁹ and the new constitution spurred hope for renewed stability. Mahuad, who had stood as the candidate of a centre-right UDC/PSC coalition, tried to co-opt the indigenous movements, for example by giving their representatives in government institutions responsibility for indigenous issues.³⁰ But high expectations the new

constitution would bring stability because it had increased presidential power were soon undermined by the inherited economic crisis³¹ and the destabilising stance adopted by Congress, which sought to regain ground lost to the executive.³²

Mahuad's government was forced to limit itself to conciliating interests. The rivalry between the coast and the highlands was sharpened by the constitutional reform that eliminated national representation in Congress.³³ Economic hardship in coastal Guayas province further promoted regional tensions and prompted the PSC, which was strong in those provinces, to distance itself from the government.³⁴ As Mahuad lacked a sufficient base to pass essential laws, he governed by decree, implementing tough economic measures that pushed labour unions – backed by CONAIE – into massive strikes that paralysed the country for ten days in March and twelve in July 1999. While he talked with the left-wing ID and indigenous Pachakutik parties to win support in Congress and tame growing popular discontent, the PSC and Guayaquil elites withdrew their support.³⁵ From August 1998 to late 1999, he tried and failed to form at least five coalitions in Congress.³⁶ With the economic crisis hitting the lower and middle classes the hardest,³⁷ the

²² Pablo Biffi, "La Crisis en Ecuador: Neutralidad de los Militares", *Clarín*, 8 February 1997.

²³ Alarcón belonged to the Frente Radical Alfariista (FRA) party. In 1995 he joined the majority coalition in Congress formed by PSC and PRE and was appointed president of Congress. In 1996 he supported Bucaram in his second round presidential campaign. He was reelected to Congress in May 1996 and reappointed president of that body.

²⁴ Vice President Rosalia Arteaga temporarily took over the presidency from 6 to 11 February. The constitution had no provision for succession in case of permanent absence. Congress used this lack of clarity to appoint Alarcón, as "interim president", a title not in the constitution. Pablo Andrade (ed.), *Constitucionalismo autoritario: los regímenes contemporáneos en la región andina*, (Quito, 2005), p. 87.

²⁵ The "pionazgo" scandal involved misappropriation of funds during his congressional presidency, 1995-1996.

²⁶ The referendum approved Alarcón's caretaker government with 68 per cent and Bucaram's removal with 75.7 per cent.

²⁷ Two traditional parties, PSC with 21 and UDC with twelve seats, had the largest representations in the assembly.

²⁸ The 1998 constitution specified it would enter into force the day the new president took office. "Constitución política de Ecuador", 5 June 1998.

²⁹ Mahuad was elected mayor of Quito twice (1992, 1996) and became a prominent critic of Bucaram. He narrowly defeated Alvaro Noboa of Bucaram's PRE party.

³⁰ The indigenous movement managed the Intercultural Bilingual Education head office, and Mahuad issued presidential decree no. 386 of 11 December 1998, allowing for management of PRODEPINE (Development Project of Ecuador's Indigenous and Black Peoples) and CODENPE

(Council of Ecuador's Nations and Peoples) by indigenous representatives. *Constitucionalismo autoritario*, op. cit., p. 91.

³¹ In 1997, extreme weather conditions caused losses estimated at 13.5 per cent of GDP. Oil prices dropped while the fiscal deficit reached 7 per cent of GDP. The 1997-1998 Asian and Russian also crises hurt the financial system, bankrupting 70 per cent of its institutions. See Section II.B. below. Ibid, p. 90. Osvaldo Hurtado, *Los costos del populismo*, (Quito, 2006), pp. 79-80.

³² Crisis Group interview, Quito, 8 June 2007.

³³ The 1998 constitution did away with the election of twelve deputies nationally. It retained two deputies for every province and one for every voting district of 200,000 inhabitants.

³⁴ Guayaquil was especially hard hit: added to the losses from floods, the "mancha blanca" disease reduced shrimp exports 62 per cent between 1999 and 2000; 68 per cent of the coast deposits were in bankrupt banks. Guayaquil's economic and political elites spoke of decentralisation, regional autonomy and even separatism. *Los costos del populismo*, op. cit., pp. 79-80.

³⁵ Mahuad agreed with the indigenous movements and labour unions to create an indigenous fund, maintain subsidies on utilities and fuels and pass a law reinstating a revenue tax, ibid, pp. 79-80.

³⁶ *Constitucionalismo autoritario*, op. cit., p. 94.

³⁷ In 1999, salaries depreciated by 10.7 per cent; urban unemployment reached 14.4 per cent and underemployment, 56.8 per cent; poverty, 46 per cent and extreme poverty 11.8 per cent. *Los costos del populismo*, op. cit., p. 82. "Social Panorama, 2006", The Economic Commission on Latin

highly-organised indigenous movement stepped up street protests.

On 9 January 2000, Mahuad announced his plan to adopt the U.S. dollar as the official currency. Under CONAIE leadership two days later, the indigenous movements set up a “people’s parliament” that called for his resignation and mobilisation of peasants. On 20 January, protesters surrounded Congress, the Supreme Court and other government institutions. The next day they stormed the Congress building. Young army officers joined the protest, and Colonel Lucio Gutiérrez, along with CONAIE leader Antonio Vargas and former Supreme Court President Carlos Solórzano, formed a “Civic-Military Salvation Junta”.³⁸ It closed down Congress and replaced it with the “people’s parliament”, which issued a decree removing Mahuad, who abandoned the presidential palace, Carondelet, when protesters broke in that same day. However, on 22 January the armed forces joint command, under Defence Minister General Carlos Mendoza, refused to recognise the Junta. Congress appointed Vice President Gustavo Noboa³⁹ as president on the questionable grounds that Mahuad had abandoned his post.

Noboa immediately implemented “dollarisation” and started negotiations with the international financial institutions (IFIs).⁴⁰ Finding agreement with the UDC/PSC legislative majority on austerity measures recommended by the IFIs proved difficult.⁴¹ Inflation

– though less pronounced than before – revived CONAIE-led protests in January 2001. In early February, after demonstrations left three protestors dead and a dozen injured,⁴² Noboa, CONAIE and other social movements reached an agreement. The government pledged to freeze petrol and household fuel prices, if the budget allowed it, refrain from raising value-added tax (VAT) and allocate more resources to development and social investment projects in the poorest indigenous communities.⁴³ While the economy eventually started to recover, privatisation of public utilities (electricity and telecommunications) could not be implemented,⁴⁴ and Noboa’s government ended enmeshed in corruption scandals.⁴⁵

Political and institutional instability continued under Gutiérrez, who was elected in November 2002.⁴⁶ The former colonel and coup leader campaigned as the candidate of the new Sociedad Patriótica party (PSP) as an “anti-party” and “anti-oligarchy” outsider in alliance with the indigenous Pachakutik party and the

America and the Caribbean (ECLAC), shows rising poverty to 1999, reaching 63 per cent (31 extreme), declining to 49 per cent in 2002 (22 per cent extreme) and 45 per cent in 2005 (17 per cent extreme).

³⁸ In an interview on 18 May 2001, Gutiérrez said “we [the military] joined the indigenous people and the different social sectors in their legitimate claims” (Crisis Group translation) and opposed the government’s orders to forcefully expel the protestors from Congress. Kintto Lucas, *El movimiento indígena y las acrobacias del coronel* (Quito, 2003), pp. 36-38.

³⁹ Noboa was not linked to any party. He was a scientist and dean of Guayaquil’s Catholic University bodies becoming Mahuad’s vice president.

⁴⁰ See Section II.B below.

⁴¹ IMF officials became involved in discussion of the law, cautioning PSC and DP legislators against introducing modifications to favour private interests. On 19 April 2000, the IMF approved Noboa’s economic plan, culminating with a \$226.7 million loan and negotiation of a twelve-month stand-by arrangement; the Inter American Development Bank (IADB/BID), the World Bank and the Andean Corporation of Development (CAF) committed over \$2 billion in additional loans. Between July and September 2000, the government renegotiated its external debt in Brady and Euro bonds, reducing it by \$2.5 billion. *Los costos del populismo*, op. cit., pp. 85-86.

⁴² “Ecuador: el Estado de Emergencia no justifica violaciones de derechos humanos”, Amnesty International, 9 February 2001.

⁴³ Among other things, Noboa pledged to increase the budget of the Council for the Development of the Nationalities and Peoples of Ecuador (CONDENPE), the National Direction for Intercultural Bilingual Education (DINEIB) and the Indigenous Health Office and social investment in the 200 poorest districts. “Acuerdo entre el Gobierno Nacional y las Organizaciones Indígenas, Campesinas y Sociales del Ecuador”, at www.llacta.org.

⁴⁴ Since 1992, the Modernisation National Council (CONAM) has established an ambitious program to reduce the size of the state, improve, modernise, decentralise and privatise state-owned companies and enhance competition. From 1993 to 1995, eleven state-owned companies were privatised; in 1998, the new constitution allowed for private ownership of “strategic” sectors (oil, electricity and telecommunications). Despite Noboa’s efforts to privatise Andinatel and Pacifictel (telecommunications) and seventeen electricity distribution companies, there was lack of interest from foreign investors, as well as legal problems regarding privatisation procedures. Fander Falconí (et al.), *Economía ecuatoriana*, (Quito, 2004), pp. 172-176.

⁴⁵ Noboa’s economy minister, Carlos Emanuel, was accused of demanding bribes from local authorities to allocate bigger budgets. Noboa’s brothers, Ricardo and Ernesto, were involved in alleged irregularities in the electricity and health sectors, respectively. On leaving office, Noboa sought political asylum in the Dominican Republic after being accused of embezzlement in negotiating the foreign debt. After he returned to Ecuador in 2005, charges were dropped.

⁴⁶ Gutiérrez defeated Alvaro Noboa of the populist PRIAN party that he created for the 2002 presidential race. Gutiérrez and Noboa obtained 20 and 17 per cent, respectively, in the first round. In the second round Gutiérrez received 55 per cent.

left-wing Popular Democratic Movement (MPD). His ties to the military and their families and background as a “man of the eastern lowlands”, a historically marginalised region, as well as Pachakutik’s strength in the central highlands and the east, were instrumental in his second-round victory.⁴⁷

The alliance with Pachakutik unravelled quickly, however, as the president gave priority to good relations with the U.S., the IFIs and Ecuador’s bankers, who held the bulk of foreign debt bonds.⁴⁸ By August 2003 the indigenous party and the largest indigenous movement organised under the umbrella of CONAIE had severed their alliance with the president, who henceforth tried to survive with arrangements between his minority bloc in Congress and the traditional parties.⁴⁹ He also neutralised the indigenous movements by exploiting deep divisions that emerged due to Pachakutik’s brief participation in a government that constituents perceived to be working against their interests.

On 20 April 2005, Congress toppled the president, once more amid popular protest and with the acquiescence of the high command, though this time the indigenous groups hardly participated.⁵⁰ In late 2004 and early 2005, the main opposition to Gutierrez came from heterogeneous and largely urban middle and upper-middle class sectors in Quito. Citizens protested against the December 2004 decision of the ad hoc coalition Gutierrez engineered with the Social Christian party (PSC) in Congress to form a new Supreme Court. The rationale of the president, who was being strongly challenged by the opposition, including Pachakutik, was to take control of the Court and establish majority PRE representation on it to pave the way for Bucaram’s return from exile in Panama. By this he hoped to receive PRE support in fighting impeachment.⁵¹

The *forajidos* (outlaws), as the protesters proudly called themselves after Gutierrez tried to discredit them with that label, succeeded not only because of their own strength but also because the government was weak and the military withdrew its support. But

the movement dissipated as quickly as it had risen, even though its basic premises were carried over into the Correa government.⁵² The outsider Gutierrez lost his grasp on power, while enjoying 40 per cent approval and a recovering economy, in large part because he was unable to establish stable alliances in Congress and end executive-legislative confrontation. Other factors were politicisation of key state institutions, persistence of corrupt, clientelistic practices and non-inclusion in politics of social and indigenous movements other than the *mestizos*, mostly in the lowlands, whom the PSP absorbed.⁵³ Gutierrez also failed to bridge the regional divide (Pacific coast, central highlands, eastern lowlands) or to transform the PSP into a party capable of aggregating interests across the country.

The government of Alfredo Palacio took office pledging to “found the country anew” by a constituent assembly or far-reaching constitutional reforms through referendum but he had no room to manoeuvre. Policies were erratic, the turnover rate of ministers was high, and the executive-legislative stand-off was not resolved.⁵⁴

B. THE ECONOMY

During the twentieth century, three commodities produced boom and bust cycles: cacao, banana and oil.⁵⁵ Shrimp, other fishing products and flowers, among other primary products that make up the lion share of the country’s exports, also contributed to growth. Natural disasters, including volcano eruptions (1999), droughts and floods (1975, 1983, 1995, 1998)

⁵² Crisis Group interview, Bogotá, 23 May 2007.

⁵³ In 2004 Welfare Minister Patricio Acosta was removed after the U.S. State Department included him in a list of foreign officials suspected of corruption. On 4 November 2004 a group of PSC, ID, Pachakutik and MPD legislators sought impeachment of Gutiérrez for embezzlement, bribery and jeopardising state security. They claimed he used public funds to finance PSP candidates in the October 2004 local elections and risked national security by requisitioning state transport for the campaign. Congress declined to impeach. “Ecuador impeachment drive dropped”, BBC News, 10 November 2004.

⁵⁴ For more detail on the Palacio administration and its efforts to introduce constitutional reform, see Ramiro Rivera, *Reforma política. Más dudas que certezas* (Quito, 2006).

⁵⁵ The cocoa boom started at the end of the nineteenth century. Banana followed during the first half of the twentieth century and was strongest in the 1950s. Oil was discovered in Oriente province in 1967, and with the completion of the trans-Andean Pipeline in 1972, Ecuador was able to begin large-scale petroleum exports. For the rise and fall of oil prices, see Paul Beckerman and Andrés Solimano (eds.), *Crisis and Dollarization in Ecuador* (Washington DC, 2002), pp. 22-25

⁴⁷ “Democracia liberal”, op. cit.

⁴⁸ Arguably, Gutierrez sacrificed his indigenous alliance to capitalise on first pay-offs of dollarisation and promote economic growth along the IFI lines, Crisis Group interview, Quito, March 2007; “Democracia liberal”, op. cit., pp. 181-182.

⁴⁹ Ibid.

⁵⁰ Like Bucaram and Mahuad, Gutiérrez was ousted on questionable constitutional grounds, since only a simple majority of Congress concluded that he had “abandoned his post” and so had to be replaced by Vice President Palacio.

⁵¹ Bucaram returned to Ecuador but fled first to Peru, then again to Panama after Gutiérrez was ousted in April 2005.

and earthquakes (1987), disrupted oil production, damaged pipelines, affected agricultural and other exports and discouraged investment. Brief wars with Peru (1981, 1995) further undermined the economic environment. These disasters were exacerbated by political stalemate that translated into a failure to define long-term economic policies,⁵⁶ the absence of diversified exports, ineffective industrial development, constant fiscal and budget crises, educational shortcomings and lavish campaign spending. Since the early 1970s, the spread of rent-seeking and corruption stimulated by oil wealth have further contributed to economic problems.

Oil revenues grew spectacularly from 1971 to 1974, especially following the opening of the trans-Andean pipeline⁵⁷ and the government's renegotiation of contract terms with the Texaco-Gulf consortium. The pipeline allowed oil from the Oriente fields in the east, discovered in 1967, to reach market. Although production increases levelled off later in the decade,⁵⁸ the large price rise of crude oil in the early 1980s led to a further surge of export revenues until the price collapsed in 1986. The March 1987 earthquake interrupted oil exports for five months.

While oil revenues were rising, Ecuador began to take on substantial amounts of foreign debt to finance the increased government spending and consequent budget deficits. External debt grew from \$328 million in 1972 to \$1.26 billion in 1977 and \$3.3 billion by 1980.⁵⁹ It fell as a percentage of GDP from 1970 to 1975 because overall GDP was expanding rapidly but by 1980 it was 52.2 per cent of GDP, over four times the 1975 level.⁶⁰ The military governments of the 1970s borrowed heavily abroad to finance current account deficits and big social and development programs but by the time civilians returned to power in 1979, the policies were unsustainable.

President Roldós was unable to push through reforms that would have used oil revenues to promote economic development, and in 1981 the World Bank refused to grant another loan. Roldós began to reduce expenditure

and control the current account deficit, including lower gasoline subsidies, higher bus fares and tariff adjustments. This resulted in protests and a national strike. His successor, Oswaldo Hurtado, announced austerity measures and began negotiations with the International Monetary Fund (IMF) to reschedule debt payments.

Making things more difficult was the fact that the price of crude oil, in particular the inflation-adjusted price, began to drop steeply in the second half of 1981 after peaking in January. The barrel price fell steadily from \$38.85 (\$92.29 in July 2007 dollars) in 1981 to \$28.80 (\$58.44 in July 2007 dollars) in January 1984, a drop in real terms of 37 per cent, while production grew by just 16 per cent from 1980 to 1983. The revenue per capita contraction was particularly sharp, as the population grew at 2.7 per cent per year in the first half of the 1980s. Agricultural commodity prices - much of the non-oil export earnings - also declined. Real per capita GDP likewise declined precipitously in the early 1980s.⁶¹

As incomes diminished, Ecuador sought assistance from the IMF for standby loans and to deal with creditors. The IMF recommended that the government devalue the sucre against the dollar, which it did in May 1982 (32 per cent) and March 1983 (21 per cent). This, combined with elimination of subsidies, reduction of protection for import-substitution industries, sales tax increases and reduction in government spending - other recommendations - contracted the economy by 2.8 per cent in 1983.

Hurtado's popularity nosedived as economic hardship led to strikes and protests. His successor, León Febres (1984-1988), established a floating exchange rate. The sucre depreciated sharply and other IMF compliance measures, such as reduced import tariffs and removal of export subsidies enabled the refinancing of debt and new loans to deal with the current account deficit.⁶² In 1985, external debt reached \$8.1 billion. The devaluation also exacerbated economic inequality: the wealthy had begun exchanging sucres in the early 1980s, while the poor had no significant savings to convert. The economic elite benefited from the loans and current account deficits the most, while structural readjustment fell in large part on the backs of the poor, who suffered from inflation, the end of subsidies and stagnant or falling wages. Urban real income declined at 8.7 per cent per year in the 1980s.⁶³

⁵⁶ *La trama de Penélope*, op. cit., pp. 17-31.

⁵⁷ The pipeline was opened in 1972. Oil export revenues went from \$1.2 million in 1971 to \$792 million in 1974.

⁵⁸ Production did not start to rise significantly past 1973's crude oil production of 209,000 barrels per day (bbl/d) until 1983, when it hit 237,000 bbl/d, and continued rising steadily until 1987, when an earthquake severely affected production, dropping the yearly average down to 174,000 bbl/d from 293,000 bbl/d in 1986.

⁵⁹ Stephen Kretzman and Irfan Nooruddin, "Drilling into Debt: An Investigation into the relationship between debt and oil", Institute for Public Policy Research and Jubilee USA Network, 2005.

⁶⁰ Wendy Weiss, "Debt and Devaluation: The Burden on Ecuador's Popular Class", *Latin American Perspectives*, vol. 24, no. 4, July 1997.

⁶¹ See Appendix B below.

⁶² The current account deficit fell from \$1.182 billion in 1982 to \$115 million in 1983; there was a surplus of \$76 million by 1985.

⁶³ "Statistical Abstracts of Latin America, 1992", as contained in Weiss, op. cit.

There was a further precipitous fall in world oil prices in 1986. High quality West Texas Intermediate (WTI) crude, for example, fell from \$22.93 per barrel in January to \$11.58 per barrel in July. This forced the government to interrupt debt service on foreign commercial loans, and the current account balance went from a small surplus to a large deficit. As the oil price began to rebound in early 1987, the devastating earthquake seriously damaged the main oil pipeline and interrupted oil exports, causing crude oil production for the year to plunge from a 1986 average of 293,000 bbl/d to 174,000 bbl/d. Other economic sectors were also heavily damaged, foreign reserves declined, the economy contracted by 6 per cent, and the currency depreciated further under speculative attacks. The current account deficit ballooned and even after oil exports resumed, the government was unable to pay \$8.2 billion on foreign debt, accumulating arrears until 1994. Under the presidency of Rodrigo Borja (1988-1992) these arrears grew by \$40 million to \$50 million per month, so that total debt exceeded annual GDP before the end of his first year.⁶⁴

Borja took office stating that “it is impossible to meet the necessities of our people and economic development and at the same time pay and service the foreign debt”.⁶⁵ Negotiations continued on the debt throughout his term but his government rejected several repayment packages. Ecuador continued to pay only 30 per cent of the interest and none of the principal. Meanwhile, living standards for most workers continued to drop in the late 1980s, and total foreign debt reached \$11.2 billion by 1990.⁶⁶ The government’s pursuit of economic growth rather than debt repayment did allow real GDP growth to exceed population growth slightly in 1990 and more strongly in 1991 but inflation did not fall much below 50 per cent per year in Borja’s term.

By the time Sixto Durán Ballén (1992-1996), who pledged to pay the foreign debt “according to our possibilities”, took office, debt arrears (interest and principle) had reached about \$4 billion, with only occasional interest payments.⁶⁷ He withdrew from OPEC at the end of 1992, after ending gasoline subsidies a few months earlier, and started to open the petroleum

and other sectors to greater foreign investment. Ecuador gained privileged access to the U.S. market in April 1993 through the Andean Trade Preference Act (ATPA). In part because of the reforms that reduced inflation and the fiscal deficit and opened the economy,⁶⁸ the country obtained a deal with creditors that reduced the principal owed by 45 per cent and restructured repayment of the remaining debt over 30 years.⁶⁹

Although there was macroeconomic recovery, the austerity program led to an increase in poverty levels to 60 per cent. Unemployment reached 15 per cent, with the majority of the economically active population underemployed by 1994.⁷⁰ Of Ecuador’s then 11.2 million people, 3.5 million were estimated to live in total indigence.⁷¹ It was an achievement to reduce the debt by 45 per cent but the country still had to dedicate considerable GDP to debt servicing. The short border war with Peru in 1995⁷² produced at least \$250 million in unplanned expenses, necessitating new taxes and budget cuts.⁷³ Matters did not improve in 1995, as drought and lack of maintenance seriously curtailed hydro-electric dams, causing brownouts and rolling blackouts, including in Quito. One bright spot was increased oil production, up to 392,000 bbl/d by 1995, but oil prices remained low, and new foreign operators were responsible for much of the increase, which meant that some profit was repatriated.

Bucaram took office in 1996, with inflation at 24 per cent (high but not by recent standards), economic growth at 2 per cent (not enough to exceed population growth) and 45 per cent of the budget used to service foreign debt.⁷⁴ Contrary to campaign promises, the president sought to peg the sucre to the dollar. The indigenous movement, trade unions and middle class

⁶⁴ David Brough, “Bankers Voice Concern About Debt”, Reuters, 17 December 1988.

⁶⁵ “Borja Says Foreign Debt Unpayable”, Reuters, 10 August 1988.

⁶⁶ After an initial burst back to 320,000 bbl/d in 1988 from 1987’s earthquake-interrupted production, crude oil production remained just under 300,000 bbl/d for three years while the price dropped steadily, lowering revenues. See Appendix B below.

⁶⁷ “Ecuador President Pledges to Pay Foreign Debt”, Reuters, 13 November 1992.

⁶⁸ Key among them the State Modernisation Law of December 1993.

⁶⁹ The original agreement was accepted by the government in May 1994 and agreed to by the over 400 creditors during the year. Ecuador also signed a letter of intent with the IMF in March that formalised and continued its participation in the structural adjustment program. In November 1994 it received a \$200 million credit from the World Bank for further reforms as part of the structural adjustment.

⁷⁰ “Ecuador: Poverty Continues to Increase despite Improved Macroeconomic Panorama”, *Chronicle of Latin American Economic Affairs*, 17 November 1994.

⁷¹ Ibid.

⁷² See Section II C, below.

⁷³ Antonio Maria Delgado, “As War Ends, Ecuador Readies to Defend Economy”, Reuters, 16 March 1995. This was an initial estimate; some estimates of the cost are much higher.

⁷⁴ “Veto Players, Fickle Institutions and Low-quality Policies: The Policymaking Process in Ecuador (1979-2005)”, Inter-American Development Bank, May 2006, p. 44.

took to the streets to protest economic policies, corruption and embezzlement of public funds.⁷⁵ When Congress ousted Bucaram, his currency plans were shelved as well. The interim Alarcón presidency was bogged down trying to clean up corruption, relying at times on the army.⁷⁶ Shortly after leaving office, Alarcón himself was arrested on corruption charges. By the time Mahuad took over in August 1998, inflation was 36 per cent, growth zero, and the sucre had lost 70 per cent of its value.⁷⁷ Constant monetary policy changes did not help: between 1995 and 1999 Ecuador altered exchange rate bands nine times, before floating the sucre.⁷⁸ Even though real per capita GDP was fairly constant,⁷⁹ the Gini coefficient, an inequality measure, rose from 0.54 to 0.59 from 1995 to 1999.⁸⁰ El Niño floods in 1998 destroyed many export crops.

As falling oil prices and the Brazilian financial crisis caused further deterioration in 1999, Ecuador defaulted on its Brady bonds.⁸¹ The government intervened directly in the financial system, in March imposing a five-day bank holiday and freezing and guaranteeing all deposits to avoid a currency collapse. The 1 per cent transaction fee initiated to raise funds led to massive withdrawal of deposits, a cash economy and closure of a number of small and medium-size banks. The Banco del Progreso, one of the largest measured by deposits, also closed.⁸² Government intervention

“saved” sixteen banks, at a cost of over five billion dollars.⁸³ One third of the Central Bank’s reserves evaporated, and monetary deposits fell by almost a quarter.⁸⁴ In desperation Mahuad gave up plans for pegging the sucre to the dollar and proposed replacing it with that currency to stop further devaluation and prevent hyperinflation. Removal of the guarantees on bank deposits prompted renewed street protests. The economy contracted by 7.3 per cent in 1999 and about 64 per cent of the population was living in poverty.⁸⁵

As the centre piece of its recovery strategy, the successor Noboa government adopted the dollar as the national currency. In March 2000 the Economic Transformation Law established measures to achieve “dollarisation”, modernise the state, stabilise the economy, build a heavy-crude pipeline and implement the IFI guidelines.⁸⁶ Additional initiatives included efforts to increase state revenues and reduce the fiscal deficit. Buoyed by rising oil prices, the economy experienced a modest recovery, with GDP rising 1.9 per cent in 2000, 5.6 per cent in 2001 and 3.5 per cent in 2002, though the trade deficit reached \$997 million in 2002.⁸⁷ Poverty rates, having briefly reached well over 60 per cent at the peak of the crisis, were still near 50 per cent in 2002.

Since then, both poverty and extreme poverty have dropped steadily, the former to 45 per cent in 2005,

⁷⁵ One of the cases was known as the “Penaranda network”, a ring of officials who provided over-priced equipment to state schools. Seventeen Congressmen were implicated and resigned. “Ecuador: who’s corrupt now, then?”, *The Economist*, 28 February, 1998.

⁷⁶ Fake “foundations” were importing second-hand clothing duty-free for victims of the natural disaster produced by El Niño; the clothing disappeared after passing customs. As President Alarcón could neither clean up nor privatise customs because of political infighting, he turned to the army to supervise operations. *Ibid.*

⁷⁷ “Veto Players”, *op. cit.*, p. 44.

⁷⁸ Gustavo Arteta and Osvaldo Hurtado, *Political Economy of Ecuador: The Quandary of Governance and Economic Development* (Quito, 2002).

⁷⁹ Real per capita GDP is calculated in Appendix B as nominal per capita GDP in dollars, given market exchange rates at the time, recalculated into 2006 dollars.

⁸⁰ “Ecuador country profile”, Pan-American Health Organization website, at www.paho.org.

⁸¹ The Brady bonds, named after the U.S. Treasury Secretary, were issued in 1989, repackaging loans as bonds, backed generally by the U.S. Treasury. Ecuador defaulted on the U.S. Treasury backed bonds while it still had foreign reserves and was also servicing other debts. See “Leaders: Desperation in Ecuador”, *Economist*, 15 January 2000; “Finance and economics: A default to order?” *The Economist*, 2 October 1999; and “Finance and economics: Latin bondage”, *Economist*, 9 October 1999.

⁸² The banking crisis started in April 1998, with closure of

a small bank, Solbanco. This triggered panic, causing even larger banks to seek Central Bank support. Small creditors were paid but many larger ones ran after their deposits for years. Luis I. Jacome, “The Late 1990s Financial Crisis in Ecuador: Institutional Weaknesses, Fiscal Rigidities, and Financial Dollarization at Work”, IMF Working Paper # 04/12 (2004), pp. 18-29.

⁸³ An estimated \$2.5 billion was transferred abroad. Alberto Acosta, Susana López, and David Villamar, *La migración en el Ecuador* (Quito, 2006), pp. 44-45.

⁸⁴ Falling international oil prices and the Latin American, Asian and Russian financial crises undermined Mahuad’s economic measures, initially applauded by the IMF and World Bank, such as elimination of subsidies for gas, electricity and diesel, raising the VAT, and taxing all banking transactions. After massive demonstrations, the government retreated. *Political Economy of Ecuador*, *op. cit.*

⁸⁵ 31.3 per cent were living in extreme poverty. “Panorama social de América Latina 2001-2002”, UN Economic Commission for Latin America and the Caribbean, (Santiago de Chile, 2002), p. 38. According to another source, the cost of the financial crisis may have reached 22 per cent of GDP, as the poverty rate peaked at 69 per cent in 2000. Carlos Larrea, “Neoliberal Policies and Social Development in Latin America: The case of Ecuador”, Congress of Social Sciences and Humanities paper, 2 June 2006.

⁸⁶ *Los costos del populismo*, *op. cit.*, pp. 85-86.

⁸⁷ *Ibid.*, pp. 88-94.

the latter to 17 per cent, though both remain higher than the Latin American average.⁸⁸ Inflation decreased from 91 per cent in 2000 to 9.4 per cent in 2002.⁸⁹ In 2001-2002 the budget was balanced, and Ecuador had the highest growth (over 5 per cent) in Latin America, though this mainly only restored the pre-crisis situation.⁹⁰ However, since then growth has continued, significantly due to high oil prices, reaching 7.9 per cent in 2004, 4.7 per cent in 2005 and an estimated 4.9 per cent for 2006.⁹¹

Oil is a capital, not labour-intensive, industry, so expanding production will not do much for serious un- and under-employment. Insufficient domestic refinery capacity, necessitating import of petroleum products, cuts into potential revenue.⁹² Popular protests reduced production by 1.2 million barrels in 2005, costing \$50 million.⁹³ In 2006, PetroEcuador's workers and contractors struck and took over some installations. A 2006 hydrocarbon law that increased the state's take from foreign/private oil companies is expected to bring in \$425 million in additional 2007-2008

⁸⁸ See "Social Panorama, 2006", op. cit., Chapter I.

⁸⁹ However, purchasing power did not increase at the same rates despite a boost from migrant remittances. *Los costos del populismo*, op. cit., pp. 88-94.

⁹⁰ The main advantages of dollarisation are the convergence of interest and inflation rates to international levels, the reduction of transaction costs by using the currency of Ecuador's international trade, the general benefits of macroeconomic stability, and the end of currency speculation, capital flight, and political interference in the exchange rate. There are disadvantages as well. Dollarisation is in effect a fixed exchange rate, and a primary import-dependent economy like Ecuador's is vulnerable with a non-competitive exchange rate. Ecuador also no longer has the monetary tools to deal with shocks such as floods, earthquakes and fluctuations in international prices for primary commodities, making adjustment to them more painful.

⁹¹ The service and manufacturing sectors, among others, also contributed to the steady growth, "Preliminary Overview of the Economies of Latin America and the Caribbean 2006", ECLAC, at www.eclac.org/publicaciones/xml/3/27543/Ecuador.pdf.

⁹² This is made more costly by the fact that Ecuador must import more expensive "light" products, such as petrol, as it produces an excess of cheaper products, such as fuel oil. In May 2006, during Venezuelan President Chávez's visit, a deal was signed to allow use of Venezuelan refineries to obtain additional product for domestic consumption but implementation has been postponed.

⁹³ "Demonstrations Cut Oil Output From Ecuador", *The New York Times*, 20 August 2005, and Juan Forero, "World Business Briefing Americas: Ecuador: PetroEcuador Revives", *The New York Times*, 23 August 2005. Output was still able to exceed that of the previous year only by a small amount.

revenue.⁹⁴ This law, upheld by the Constitutional Court in August 2006, may make Ecuador significantly less attractive for investors, though high oil prices and lack of countries with more favourable terms may mean there will not be much immediate impact. Confiscation of the assets of Occidental Petroleum in May 2006 has had stronger repercussions. Regardless of the merits of that case, the penalty of losing assets worth over \$1 billion (its entire Ecuadorian investment) was widely seen by investors and the U.S. government as excessive.⁹⁵

Occidental has since pursued arbitration against the government but President Correa stated his administration does not recognise the authority of World Bank's International Centre for Settlement of Investment Disputes. This also has serious ramifications for the investment climate and Ecuador's bilateral investment treaties, such as the one it has with the U.S. calling for international arbitration to be respected.⁹⁶ PetroEcuador, which took over Occidental's operations, has not been able to maintain production, which has fallen by about 30 per cent from 100,000 bbl/d.⁹⁷

Free trade agreement (FTA) negotiations with the U.S. were suspended as a result of the Occidental dispute,⁹⁸ Those negotiations were, however, already unpopular in Ecuador. In March 2006, President Palacio declared a state of emergency, as thousands, including indigenous groups, paralysed commerce and traffic for ten days

⁹⁴ "Ecuador Wins Key Legal Rulings for New Oil Law, Oxy Seizure", *Oil Daily*, 25 August 2006.

⁹⁵ Occidental, which won a \$75 million international arbitration case over VAT rebates in 2004, was accused of transferring a 40 per cent stake in concessions to EnCana without proper notification to the government. That Occidental was later apparently willing to pay some kind of substantial penalty and the assets EnCana acquired were soon sold to the consortium Chinese Andes Petroleum without problems, despite allegations EnCana also did not get proper permission, have led some observers to suggest the decision was politicised. The Palacio government was under great public pressure to punish Occidental, particularly since it was seen as arrogant for having pursued the VAT case.

⁹⁶ "Leaders: The battle for Latin America's soul", *Economist*, 20 May 2006.

⁹⁷ More recently, Petrobras has also come under threat of expropriation of assets for alleged violations of its operating contract. It produces about 36,000 bbl/d in Ecuador. Hal Weitzman, "Ecuador Threatens Petrobras", *Financial Times*, 9 July 2007.

⁹⁸ While the Bush administration froze the negotiations in May 2006, as a response to the government intervention against Occidental Petroleum, they were faltering on a number of other issues: copyright, agriculture and investment, among others. "US/Ecuador free trade agreement frozen", 14 May 2006, at www.bilaterals.org.

in Quito and surrounding areas in protest.⁹⁹ Nevertheless, Ecuador's trade preferences in the U.S. have been extended through February 2008.¹⁰⁰

Despite the Occidental case, oil production is still mainly in foreign hands.¹⁰¹ State-owned PetroEcuador's production has decreased from 120 million barrels in 1994 to 60 million in 2007.¹⁰² While in 1995 it produced 81 per cent of the crude oil, ten years later it produced less than 40 per cent.¹⁰³ Governments since the early 1990s have tried to attract outside capital, including through privatisation of part of the oil industry.¹⁰⁴ Legislative changes were made to allow different operating service contracts and production-sharing agreements (PSAs). In particular, the reform of the hydrocarbon law in December 1993 and elements of the 1998 constitution attracted foreign companies at a time of low oil prices. The government held bidding rounds that brought companies in to explore and develop new resources, as well as undertake joint ventures with PetroEcuador.

Production began to take off in the late 1990s, particularly from Arco, Repsol/YPF, and Occidental. By early 2001, as much as 100,000 bbl/d of potential production

was limited by the capacity of the SOTE Pipeline.¹⁰⁵ The Oleoducto de Crudos Pesados (OCP) pipeline, built by a consortium of many of the foreign companies then operating in Ecuador, went online in 2003, boosting their production by about 140,000 bbl/d within months and making them the major producers in the country.

PetroEcuador's inefficiency is largely due to insufficient investment and modernisation, as well as politicisation of its management.¹⁰⁶ Since the 1990s, it has had difficulty maintaining production, as falling prices, political unrest, natural disasters and government dependency on oil revenue have left insufficient funds for reinvestment.¹⁰⁷ Even as prices increased in the 2000s, this remained a problem. For example, in 2005 the company identified 157 investment projects that could not move forward, even after increasing its investment budget by 89 per cent, to \$338.8 million.¹⁰⁸ In addition, many of its fields are past peak production, with annual decline rates of 3 to 7 per cent.¹⁰⁹ PetroEcuador has labelled the current production situation "deplorable" and does have a plan, however, for an aggressive drilling program to turn business around.¹¹⁰

Nevertheless, the 2007 forecast is for a 5 per cent decrease in PetroEcuador's oil production to the lowest level in at least a decade.¹¹¹ Although Ecuador has less than 1 per cent of the world's crude oil reserves and of crude trade,¹¹² the "natural resources curse" is a menace to any political system as dependent as Ecuador's

⁹⁹ As a consequence of widespread criticism of the proposed Andean Free Trade Agreement (FTA) in and outside Ecuador, the U.S. shifted to individual negotiations with Peru and Colombia. See "Is the US free trade model losing steam?", American Friends Service Committee, 3 May, 2006 at www.afsc.org; "World Briefing Americas: Ecuador: Government Clamps Down On Protests", *The New York Times*, 23 March 2006; and "World Briefing Americas: Ecuador: Indians Protest Free-Trade Talk With U.S.", *The New York Times*, 16 March 2006.

¹⁰⁰ See usfederalnews.blogspot.com/2007_07_01_archive.html.

¹⁰¹ Seventeen transnational oil companies are operating in Ecuador, among them U.S., Chinese, Brazilian, Chilean, Canadian and Korean companies. Crisis Group interview, Quito, 8 June 2007.

¹⁰² Crisis Group interview, mining and energy ministry official, Quito, 8 June 2007.

¹⁰³ The state-owned PetroEcuador was founded in 1989, successor to CEPE (Corporación Estatal Petrolera Ecuatoriana) which was formed in 1972. It has become a milk cow for the political elite, and Correa promised during the campaign to end the plunder. *Economist*, 12 October 2006; Crisis Group interview, mining and energy ministry official, Quito, 11 June 2007. Since taking over Occidental's assets, PetroEcuador's share has gone up, initially from about 37 per cent to 46 per cent.

¹⁰⁴ This was encouraged by the IFIs: "World Bank Helping Ecuador Oil Privatisation Study", Reuters, 6 November 1992.

¹⁰⁵ Peter Gall, "Ecuador Heavy Oil Pipeline Deal Ready for Signatures, Energy Minister Teran Says", *The Oil Daily*, 12 January 2001.

¹⁰⁶ In the sixteen years of its existence, PetroEcuador has had 22 presidents, Crisis Group interview, mining and energy ministry official, Quito, 11 June 2007.

¹⁰⁷ "Ecuador State Oil Firm Says Needs New Investment", Reuters, 25 February 1997.

¹⁰⁸ "Ecuador: Petroecuador Suffers with Budget Restraints", *Diario Expreso*, 8 December 2005. However, this put the company in the red in 2006.

¹⁰⁹ In September 2000, then Energy Minister Pablo Terán, when discussing the largest fields, noted that "in the last five years investment in fields like these has been almost nil. Wells have been closed for lack of a fuse. This is crazy". "Pipe Dreams", *LatinFinance*, 1 September 2000.

¹¹⁰ "Ecuador to Begin 'Aggressive Exploration' Program: Oil Official", *Platts Commodity News*, 9 March 2007.

¹¹¹ "PetroEcuador con menor producción de crudo en el 2006", *El Universo*, 9 January 2007; Crisis Group interview, Quito, 8 June 2007. Of course, there was a net gain with the addition of Occidental's assets.

¹¹² Genaro Arriagada, "Petropolitics in Latin America", *Inter-American Dialogue*, 2006, p. 10.

is on oil,¹¹³ as its recent economic and political history shows.

Debt service since 1999 has decreased as total foreign debt has fallen from a peak of over \$17 billion in 2004 to \$10.4 in 2007. The debt service per GDP ratio, 3.6 per cent in 1993 and 10 per cent in 1997-2000, has levelled off at 7-8 per cent.¹¹⁴ Despite the trend, Standard & Poor rates Ecuador among the least reliable debtors because of constant political upheavals.¹¹⁵ President Correa has declined cooperation with the IMF economic review and expelled the World Bank representative, as debt payment has increasingly become a political issue. Venezuelan President Hugo Chavez has urged Ecuador to “liberate” itself from the IFIs and offered help with early repayment.¹¹⁶ Ecuador has not accepted the Venezuelan offer but is also challenging the World Bank and IMF by questioning again the servicing of its foreign debt.¹¹⁷ It did pay \$135 million on its bonds in February 2007, though some analysts have asserted this was only because it was not yet prepared to default on the debt.¹¹⁸

C. RELATIONS WITH PERU AND COLOMBIA

In territory, population and economy, Ecuador is small compared to neighbouring Colombia and Peru.¹¹⁹

¹¹³ Ecuador fits the basic definition of a resource curse country, one not benefiting economically despite large-scale export of the resource, but it has some unique features. For example, for most of its history, it did not experience “Dutch Disease”, appreciation of its currency due to commodity export income making manufacturing export industries uncompetitive; instead it had to deal with depreciation after the initial boom. For reporting on resource curse issues, see Crisis Group Africa Report N°113, *Nigeria: Want in the Midst of Plenty*, 19 July 2006 and Crisis Group Asia Report N°133, *Central Asia’s Energy Risks*, 24 May 2007.

¹¹⁴ *La migración en el Ecuador*, op. cit., p. 49.

¹¹⁵ Its CCC+ sovereign credit rating is among the lowest among the 113 countries rated, see <http://www.businessweek.com>.

¹¹⁶ Luis Oganés and Ben Ramsey, “Markets Fret Over Ecuadorean Debt”, *Viewpoints America*, vol. 6, issue, 2, 11 December 2006, p. 2.

¹¹⁷ Hal Weitzman, “Ecuador Warns of Default on Foreign Debts”, *Financial Times*, 5 July 2007.

¹¹⁸ Kenneth S. Levine, “Arming for an Ecuador Default”, *LatinFinance*, 1 April 2007. The payment has also been associated with corruption allegations. For more on this, see Section III C 2 below.

¹¹⁹ Colombia is roughly four and Peru four and half times the size of Ecuador. Their populations are more than three and two times, respectively, larger than Ecuador’s. In 2006, Ecuador’s estimated GDP per capita was \$4,500. Colombia’s and Peru’s were \$8,600 and \$6,600, respectively.

Recent troubled relations have origins in the unclear territorial organisation of the Spanish empire and boundary disputes after its secession from Great Colombia in 1830. The 1941 war with Peru, settled by the Rio Protocol,¹²⁰ cut Ecuador’s direct access to the Amazon basin and conceded to Lima approximately 200,000 sq. km.¹²¹ In 1981, two years after returning to democracy, Ecuador fought a brief border war with the old enemy, “the Paquisha Incident”, over control of three military posts. Increased military presence at the border after the war generated sporadic further violence.¹²² President Alberto Fujimori of Peru sought improved relations, in part because of his mounting domestic problems. However, in January 1995 fighting broke out again at the undemarcated border in the Cenepa Valley. It lasted for nineteen days and cost an estimated \$1 billion¹²³ before the guarantors of the Rio Protocol (Argentina, Brazil, Chile and the U.S.) brokered a ceasefire.¹²⁴

In 1998, Presidents Fujimori and Mahuad finally signed a comprehensive peace accord, “the Brasilia Presidential Act”. As a symbolic gesture, one square kilometre at the site of fiercest fighting, Tiwinza, on the Peruvian side, was given to Ecuador as non-sovereign, private property.¹²⁵ Both parliaments ratified the agreement, and demarcation started in May 1999. Additional agreements were signed, including a binational development plan for the border region.

While Ecuador concentrated on its southern border, it long neglected the northern frontier with Colombia.¹²⁶ Until the 1998 peace accord with Peru was signed, and spillover from Colombia’s intensified civil conflict

¹²⁰ Brazil, Argentina, Chile and the U.S. brokered and guaranteed the “Treaty of Peace, Friendship and Boundaries between Peru and Ecuador”, signed on 29 January 1942.

¹²¹ This meant Ecuador lost almost half its territory.

¹²² Beth A. Simmons, “Territorial Disputes and their Resolution, The Case of Ecuador and Peru”, *Peaceworks*, no. 27 (1999), p. 11.

¹²³ It is estimated that 34 Ecuadorian soldiers died and 89 were wounded, while Peru lost 168 dead. “Territorial Disputes”, op. cit.

¹²⁴ Military officers of the guarantor nations supervised the ceasefire and separation of troops, which would otherwise have been problematic, given the difficult terrain and lack of communications between the belligerents.

¹²⁵ Ambassador Luigi Einaudi, the U.S. representative, is credited with the idea. Ecuador can use it for commemorative and other symbolic uses, including flying its flag.

¹²⁶ Crisis Group Latin America Report N°3, *Colombia and its Neighbours: the Tentacles of Instability*, 8 April 2003; Crisis Group Latin America Report N°9, *Colombia’s Borders: The Weak Link In Uribe’s Security Policy*, 23 September 2004.

became manifest, only 2,000-4,000 of the country's 60,000 troops were deployed in the north.¹²⁷ Quito then sent more troops north and stepped up border-related diplomacy.¹²⁸ Ecuador is acutely aware of the threat posed by that conflict, including the destabilising impact of trafficking in drugs and contraband precursors.¹²⁹ Successive governments have maintained that Ecuador wants no part of the war, and it is Colombia's responsibility to halt the spill-over.¹³⁰ Aerial spraying of coca crops along Colombia's southern border, which started with Plan Colombia in 2000,¹³¹ has been a constant source of controversy, and in July 2007 the Correa government decided to file suit against Colombia at the International Court of Justice in The Hague.¹³²

The presence of Colombian armed groups in Ecuador is a serious concern for both Quito and Bogotá. Nueva Loja, the capital of Sucumbios province bordering Colombia, has for years been a center for medical assistance, rest and equipment for Colombian guerrillas and paramilitaries.¹³³ In January 2004, Ecuadorian authorities arrested and deported FARC commander Ricardo Palmera, alias Simón Trinidad, who was then extradited to the U.S. While Quito has repeatedly underscored that it played no part in Plan Colombia, it has been willing to cooperate in fighting drugs.¹³⁴ In 1999, President Mahuad signed a ten-year agreement with the U.S., creating a Forward Operating Location (FOL) in the Pacific seaport of Manta, which replaced Panama as the centre for U.S. surveillance in the region.¹³⁵ From there U.S. personnel fly reconnaissance over Colombia, Peru and Bolivia.

In 2005, a law defined money laundering as a criminal activity and foresaw establishment of a financial intelligence unit. The increased policing has produced results. Between 1999 and 2003 the authorities seized an average of eight tons of cocaine. This increased to 44 tons in 2005. In the first quarter of 2006, eleven tons were seized during Operation Pacific Storm, which dismantled a major trafficking organisation.¹³⁶

Ecuador has received the major inflow of Colombian refugees and numbers are rising. During the 1990s, applications averaged 60 a year.¹³⁷ Between 2000 and 2006, more than 40,000 Colombians officially asked for refugee status, 72 per cent of all applications in neighbouring countries.¹³⁸ However, most refugees and migrants in Ecuador are not registered and live illegally. The authorities estimate there may be 500,000 Colombian citizens in the country.¹³⁹ The increase in numbers of illegals has become an issue of public concern. According to a 2006 poll, 74 per cent of Ecuadorians were against Colombian immigration; 35 per cent favoured deporting illegal Colombian migrants.¹⁴⁰ The new government is considering massive legalisation of the migrants.

In the midst of a diplomatic row with Bogotá over aerial spraying of coca crops on Colombia's southern border, the Correa administration launched Plan Ecuador and earmarked \$145 million for it in 2007. It aims, in part in collaboration with Colombia, at controlling the spillover effects of the neighbour's conflict by fostering infrastructure and socio-economic development, environmental protection and human rights in border municipalities. Its timeframe is through 2018, and the government seeks substantial donor help. Colombia has so far shown little interest, however, since it is perceived as a counter to Plan Colombia.

¹²⁷ "Seguridades en construcción en América Latina" Tomo I. CEPI, Bogotá, 2005, pp. 77, 83; Crisis Group Report, *Colombia and its Neighbours*, op. cit.

¹²⁸ Some 11,000 troops are now deployed along the border with Colombia. Crisis Group interview, Quito, 11 June 2007.

¹²⁹ Crisis Group Report, *Colombia's Borders*, op. cit.

¹³⁰ Cesar Montúfar, "Colombia, desde la mirada ecuatoriana", *UN Periódico*, no. 102, 20 May 2007, p. 6.

¹³¹ On the multi-billion dollar U.S.-Colombian strategy to combat drugs and the illegal armed groups in Colombia, see Crisis Group Report N°1, *Colombia's Elusive Quest for Peace*, 26 March 2002.

¹³² Markus Schultze-Kraft, "Una propuesta constructiva", *El Tiempo*, 9 April 2007; Constanza Vieira, "Colombia-Ecuador: Coca Spraying Makes for Toxic Relations", *ipsnews*, 24 July 2007.

¹³³ Montúfar and Whitfield, op. cit., p. 217.

¹³⁴ Crisis Group interview, political analyst, Quito, 28 March 2007.

¹³⁵ Since it was not a treaty, the Ecuadorian Congress could not scrutinize the deal, though it turned to the Supreme Court, which upheld the accord. *The New York Times*, 31 December 2000.

¹³⁶ "International Narcotics Control Strategy Report", U.S. Department of State, 2006, p. 57.

¹³⁷ Consuelo Beltrán, Álvaro Moreno, Javier Sánchez (et al.), *El desplazamiento forzado de colombianos hacia Ecuador en el contexto del Plan Colombia* (Bogotá, 2004), p. 60.

¹³⁸ "Más o menos desplazados", CODHES, September 2006, p. 15.

¹³⁹ "Ecuador aplaza lanzamiento de su contraofensiva diplomática al Plan Colombia", *El Mercurio*, 8 April 2007.

¹⁴⁰ "Ecuador: 74% de la población contra inmigración colombiana", *La Hora*, 4 September 2006.

III. THE CORREA ADMINISTRATION

A. THE 2006 ELECTIONS

On 26 November 2006, Rafael Correa defeated Alvaro Noboa in the second round of the presidential election. The candidate of the left-wing Alianza País (AP)¹⁴¹ won 57 per cent of the vote, shattering the hopes of the multimillionaire, three-time candidate and leader of the populist Partido Renovación Institucional Avanzada Nacional (PRIAN), who led the first round and has still not acknowledged the result.¹⁴² Reversing the belligerence that marked his campaign, in particular during the first round, Correa struck a conciliatory note, saying there were no “winners and losers”, but also that he represented the “eagerness for change...after years of darkness”.¹⁴³

Several factors played a role in Correa’s victory in a campaign marked by apathy and uncertainty.¹⁴⁴ The outgoing Palacio administration had failed to produce promised constitutional reforms and stability. In the early days of the campaign, the candidates were acutely aware of the difficulties they would face in living up to their pledges. Executive–legislative stand-offs and fragmentation within the latter had been constants during the two previous administrations.¹⁴⁵ Political parties and Congress alike were discredited. Surveys

conducted at the beginning of the campaign in August showed 75 to 80 per cent of the voters were undecided.¹⁴⁶

After an attempt to build a minimum common platform (*concertación*) between the parties failed,¹⁴⁷ León Roldós, who was backed by the Red Ética y Democracia (RED) and social-democratic Izquierda Democrática (ID), and Noboa were the early leaders. Correa, who was also supported by the small Partido Socialista-Frente Amplio (PS-FA), was given little chance, as were Cynthia Viteri of the conservative Partido Social Cristiano (PSC), who was hampered by party infighting;¹⁴⁸ Gilmar Gutiérrez of the populist Partido Sociedad Patriótica (PSP), brother of the former president; and Luis Macas of the indigenous, leftist Movimiento de Unidad Plurinacional Pachakutik-Nuevo País (MUPP-NP). An alliance between PRIAN, Partido Roldosita Ecuatoriano (PRE) and PSP did not materialise. In one way or another, all candidates advocated deep reforms; the dividing line was whether these should be brought about by a constituent assembly (Roldós, Correa, Gutiérrez and Macas), or Congress (Noboa and Viteri).

Correa’s chance came when Roldós, who was competing for the same voters on the left, became tangled in the ambiguities of his promises and unwisely approached business sectors in an attempt to emulate the Chilean model of economic growth and social equity.¹⁴⁹ Correa capitalised on his image as an “anti-party outsider”, campaigning with strong nationalist overtones including promises to overhaul the political system in the constituent assembly (CA) and attacking an FTA with the U.S. and the U.S. military base (FOL) in Manta. As part of a strategy to delegitimise Congress that ultimately failed, AP offered no parliamentary candidates.¹⁵⁰

¹⁴¹ Alianza País was founded in 2005 by Rafael Correa and left-leaning intellectuals, including Gustavo Larrea, Alberto Acosta, Ricardo Patiño, Vinicio Alvarado and Manuela Gallegos. It has incorporated a growing number of leftist political and social organisations and movements, such as Acción Democrática Nacional, Iniciativa Ciudadana, Movimiento Ciudadano por la Nueva Democracia, Ciudadanos Nuevo País and Alternativa Democrática. Crisis Group interview, political analyst, Quito, 8 June 2007.

¹⁴² Crisis Group interview, leading PRE member, Guayaquil, 12 June 2007. In 1998 and 2002, Noboa made it to the second round, standing against Jamil Mahuad and Lucio Gutiérrez, respectively. On both occasions, he was second in the first round and lost by relatively small margins in the second (49/51 per cent in 1998, and 46/54 per cent in 2002). Noboa won 27 per cent of the vote and Correa 23 per cent in the first round on 15 October 2006. Gilmar Gutiérrez of the Sociedad Patriótica (PSP) party and brother of former President Lucio Gutiérrez was third with 17 per cent.

¹⁴³ First speech of the newly elected president, available at www.ecuadorelige.com.

¹⁴⁴ See *Vanguardia*, August–November 2006.

¹⁴⁵ Crisis Group interview, political analyst, Quito, 26 March 2007.

¹⁴⁶ *Vanguardia*, 15–21 August 2006.

¹⁴⁷ The common agenda and platform was promoted by the leader of the Nuevo País party, Freddy Ehlers, and supported by Quito and Guayaquil Mayors Oswaldo Moncayo (ID) and Jaime Nebot (PSC), respectively. It aimed at establishment of a “transition government” capable of guiding Ecuador out of its political and institutional quagmire. *Vanguardia*, 8–14 August 2006.

¹⁴⁸ The PSC was split between its long-time strongman and former President León Febres Cordero and Mayor Jaime Nebot of Guayaquil. The candidate, Cynthia Viteri, basically had to campaign without party backing. Crisis Group interview, ex-presidential candidate, Guayaquil, 12 June 2007.

¹⁴⁹ Crisis Group interview, RED legislator, Guayaquil, 11 June 2007.

¹⁵⁰ The strategy, known as *voto nulo*, did well only in the central highland province of Pichincha, where 33 per cent voted “nil”.

Noboa sought confrontation with Correa, calling him a “communist”,¹⁵¹ and made populist campaign pledges, including to build 300,000 houses for the poor yearly. He also stepped up his campaign for facilitating foreign investment and making the market work. This was effective in the first round and prompted AP and Correa first to cry foul and denounce fraud, then to make significant adjustments for the second round, including jettisoning the outsider image for a more moderate one. Instead of focusing on the CA, the FTA and the Manta base, he lowered his belligerence and promised to increase social spending, reduce value added tax and give entrepreneurs cheap credit.¹⁵² He also distanced himself from Venezuela’s Chávez, whose public support had cost him first-round votes.

In the runoff, Correa gained the better part of the centre-left and indigenous vote as well as much of the support that had gone to Gutiérrez.¹⁵³ Noboa led only in the PRIAN and PRE strongholds in the coastal provinces of Guayas and Manabí. Correa’s victory over the banana magnate was based not so much on alliances with other parties as Ecuadorians’ unwillingness to put Noboa in the Carondelet palace.¹⁵⁴ The AP strategy of not presenting Congressional candidates helped by underscoring Correa’s determination to break with the past of congressional inefficiency and corruption but also prepared the ground for the virulent confrontation with an opposition legislature that marked the first months of the new administration.

¹⁵¹ During the televised debate broadcasted by CNN en Español on 5 October 2006, Noboa used Correa’s friendship with Hugo Chávez and Fidel Castro as well as his hesitation to refer to the FARC as a terrorist group to portray him as a communist and a friend of Colombia’s largest insurgent group.

¹⁵² Correa also repeatedly criticised Noboa for using child labour on his banana plantations.

¹⁵³ Gutiérrez won a surprising 17 per cent in the first round, mainly in the Amazon lowlands, as well as on the coast and in the central highlands. Other first-round losers whose supporters generally migrated to Correa included Roldós (15 per cent), Viteri (just under 10 per cent) and Macas (just over 2 per cent). Gutiérrez and the PSP had campaigned strongly at the community level in the eastern lowlands and El Oro, Los Ríos, Manabí, Pichincha and Azuay provinces in the central highlands and the coast. One of his tactics was to hand out tools to small farmers. Crisis Group interview, political analyst, Quito, 26 March 2007.

¹⁵⁴ Hernán Ibarra, “La Victoria de Rafael Correa y la ola progresista en América del Sur”, *Ecuador Debate*, no. 69 (2006), p. 18.

B. THE NEW GOVERNMENT’S PEOPLE AND PROGRAM

Judging by the professional and political background of its members, the new government exhibits some features that distinguish it from its predecessors. The president and several key ministers are in their 40s, with considerable social science expertise but little or no political party or governmental experience. Until his five months as economy minister at the start of Palacio’s term, Correa was little known in political circles and social movements. After earning his MA in economics at the Catholic University of Louvain-la-Neuve in Belgium in 1991, he worked as economics professor at the prestigious San Francisco University in Quito. In 2001, he earned his Ph.D. from the University of Illinois (U.S.). His academic work exhibits deep interest in macro-economics, monetarism, social justice, poverty reduction and national sovereignty.¹⁵⁵ According to academic sources in Quito, he is on the Left but not a Marxist.¹⁵⁶ Alluding to a Catholic upbringing, Correa has referred to himself as a “Christian on the Left”.

Ricardo Patiño, Correa’s first economy minister,¹⁵⁷ and Fander Falconi, the national secretary for planning and development, worked for years in left-leaning research institutions in Quito, such as the Facultad Latinoamericana de Ciencias Sociales (FLACSO) and the Instituto Latinoamericano de Investigaciones Sociales (ILDIS) funded by the German Social Democratic Party. So did Alberto Acosta, the energy and mining minister until he resigned to stand for the CA. Before joining the cabinet, Foreign Minister María Espinosa and Interior Minister Gustavo Larrea headed the Unión Internacional para la Conservación de la Naturaleza (UICN) in South America and the Latin American Association of Human Rights (ALDHU) in the Andean region, respectively.¹⁵⁸ The internal and external security minister, Fernando Bustamante, was a political science professor at San Francisco University in Quito. Close links between academe and the cabinet persist, with the former

¹⁵⁵ See his *La vulnerabilidad de la economía ecuatoriana: hacia una mejor política económica para la generación de empleo, reducción de la pobreza y desigualdad* (Quito, 2004); and “Ecuador: de absurdos dolarizaciones a uniones monetarias”, in Rafael Quintero & Erika Silva, (eds.), *Hacia un modelo alternativo de desarrollo histórico* (Quito, 2005), pp. 299-308.

¹⁵⁶ Crisis Group interviews, Quito, March 2007.

¹⁵⁷ After being censured by Congress (see Section III.C.2 below), Patiño was replaced by Fausto Ortiz in July 2007. He is now minister for the Pacific coast (*Ministro Coordinador del Litoral*).

¹⁵⁸ Larrea, older than most of his colleagues, was under secretary at the interior ministry under President Bucaram, 1996-1997.

acting as a sounding board for the latter's ideas.¹⁵⁹ The same is true for a number of political and social organisations and movements and NGOs.

Another distinctive feature is participation of several members, including Correa, in the "forajido movement" that took an important part in ousting Gutierrez in 2005.¹⁶⁰ Correa's themes of ending the power of the "political mafias", cleaning up the discredited Congress, courts and state institutions, enhancing citizen participation in politics and producing a "citizen revolution" (*revolución ciudadana*) have roots in the protest movement of 2004-2005. Since its creation in late 2005, AP has defined itself as a "progressive" movement emphasising citizen participation, social equity, "ethical" politics, cultural and social diversity and solidarity among citizens. According to an official, it includes or is supported by more than 200 social organisations and left-wing parties, such as Democratic Alternative (AD), the Socialist Party (PS-FA) and the Popular Democratic Movement (MPD).¹⁶¹

Correa's campaign program, which is being worked into a national development plan with the participation of citizens and social organisations,¹⁶² featured some classic socialist and social democratic elements, such as enhancement of the state's role in the economy and extensive social welfare. The CA is seen as the first step toward building a new social pact and far-reaching institutional, political and economic reforms.¹⁶³ Since his days as a professor, Correa has been a harsh critic of neo-liberal economic policies. Instead of following IFI recipes as most of his predecessors since 1979 have attempted, he has been emphasising a stronger state role in the economy to achieve development and social equity. Increased public investment is planned in agriculture, telecommunications and energy, particularly in refining so as to reduce dependence on imports of crude oil derivatives. While the issue has not been addressed explicitly, he and the AP have not ruled out nationalisation of key sectors.

Social issues, including creation of quality jobs and investment in education and universal health coverage, are at the centre of Correa's project. Women are targeted by reforms to enhance gender equality and

economic autonomy.¹⁶⁴ The project also advocates public policies that take into account multiculturalism and indigenous peoples and improve social cohesion among the poor majority.¹⁶⁵ The remittances of more than one million Ecuadorians abroad¹⁶⁶ (out of what is now a population of 13.8 million) are 7 per cent of annual GDP.¹⁶⁷ Correa has pledged to defend Ecuadorian migrants' rights and create conditions at home that would encourage them to return.

Although Correa has not sought confrontation with the U.S., he has said he will not renew the military base at Manta.¹⁶⁸ He has reaffirmed neutrality in the Colombian conflict and enthusiastically promotes Latin American integration, even using some of Hugo Chávez's Bolivarian sovereignty rhetoric.¹⁶⁹

C. POLITICAL STRUGGLE AND THE CONSTITUENT ASSEMBLY

With the 15 April 2007 referendum on the CA, Correa moved a step closer to fulfilling his main campaign promise and political goal: profound institutional, political and economic change through rewriting the constitution. The "yes" vote was 82 per cent, turnout 71 per cent. The OAS Electoral Observation Mission, led by former

¹⁶⁴ Women's associations actively participated in developing Correa's campaign program. "Plan de gobierno del Movimiento PAIS 2007-2011: un primer gran paso para la transformación radical del Ecuador", Alianza País, 2006, pp. 76-77.

¹⁶⁵ For instance, study of indigenous languages is to be encouraged, *ibid.*, p. 9. Correa pledged to double the Human Development Bond for keeping children at school and the Housing Bond; lower bank interest rates and issue cheap credit for productive sectors, including "555", a micro-credit plan mainly targeting women and youth (granted by the Banco Nacional de Fomento, the credits can be up to \$5,000 for five years at five per cent); and prepare a law for restructuring the social security system.

¹⁶⁶ Official figures for 2005 are 436,000 in the U.S., 487,000 in Spain and 62,000 in Italy. Estimates for these three countries are close to 1.3 million. See Brad Jokisch, "Ecuador: Las cifras de la migración nacional", at www.migrationinformation.org.

¹⁶⁷ According to the Foundation for International Migration and Development, the remittances were 7.02 per cent of GDP in 2006, at www.remittances.eu.

¹⁶⁸ Crisis Group interview, U.S. embassy official, Quito, 30 March 2007.

¹⁶⁹ "Plan de gobierno del Movimiento PAIS 2007-2011", *op. cit.*, p. 9.

¹⁵⁹ Crisis Group interview, political analyst, Quito, 27 March 2007.

¹⁶⁰ Crisis Group interview, political analyst, Quito, 26 March 2007. See section II.A above.

¹⁶¹ Crisis Group interview, internal and external security ministry official, Quito, 11 June 2007.

¹⁶² Crisis Group interview, national planning agency official, Quito, 8 June 2007.

¹⁶³ See section III.C below.

Chilean Interior Minister Enrique Correa, found no major irregularities.¹⁷⁰

This victory was preceded by one of the nastiest political episodes since the 1979 return to democracy, involving the executive, Congress and the judiciary. The essence of Correa's "shock therapy" has been fighting the opposition-dominated legislature and holding the CA referendum.¹⁷¹ His initial signals of seeking rapprochement with the traditional parties faded quickly.¹⁷² All sides resorted to constitutionally and legally questionable actions in the referendum fight, further undermining the already weak rule of law.¹⁷³ In the course of a struggle in which law and the constitution were constantly invoked, Ecuador's legal and normative framework, as an analyst aptly put it, was "reduced to jelly".¹⁷⁴

Sectors close to the government, including the leftist MPD, which has three seats in Congress, staged occasionally violent protest marches against the "corrupt political mafias" said to control Congress and key state institutions.¹⁷⁵ Provoked by the opposition's intransigence and determination to use any means available to stop the CA, Correa also used highly confrontational language in the lead up to the referendum, while only vaguely defining what the new constitution should look like.

In hindsight, it is clear the Congress did not realise how low its public standing was and mistakenly believed it could continue with politics as usual. It also underestimated the president's astuteness and the strength he derived from his election and approval rating, which was 73 per cent on taking office and still at 62 per cent in June, dropping slightly to 59 per cent in July.¹⁷⁶ In its first 100

days, the new government gained control of all key institutions, including Congress, the Constitutional Court (TC) and the Electoral Tribunal (TSE). The means employed, while questionable from a constitutional perspective,¹⁷⁷ are defended by officials as legitimate in the circumstances, including opposition plotting.¹⁷⁸

1. Applying shock therapy

Correa made clear from the start that he would not compromise his main goal of establishing the CA. During his first ten weeks, he struggled relentlessly against the opposition majority in Congress and its representatives in key state institutions, such as the Electoral Court (TSE), that was determined to block the initiative. He quickly issued Presidential Decree no. 2 for an 18 March 2007 referendum on establishment of the CA. This constitutionally questionable procedure¹⁷⁹ was followed, a week later, by Decree no. 54 modifying the CA rules set out in the first decree.¹⁸⁰ The seven-member TSE, including four from opposition parties,¹⁸¹ ruled the referendum required Congress' approval. This sparked a round of street protests, allegedly backed by the president, aimed at putting pressure on the legislative branch.¹⁸²

Comercio, 2 August 2007. Other polls show that 44 per cent say the country is better off than before the election and 73 per cent that it is going the right way. "Cien primeros días de gestión", *El Mercurio*, 25 April 2007. For May (67 per cent) and June approval figures, see Cedatos/Gallup poll, 16 June 2007.

¹⁷⁷ See below.

¹⁷⁸ Crisis Group interview, ministry of internal and external security official, Quito, 8 June 2007.

¹⁷⁹ Correa based his decision to call a referendum by decree on Articles 171-6 and 104-2 of the constitution, which say the president can call a *consulta popular* when he believes the issues involved are of vital national importance. However, Articles 104-1 and 104-2 specify that these issues should not include reform of the constitution. For that, Article 283 would seem to apply. It states that the president can call for a referendum on a constitutional reform only if a majority of Congress has qualified the reform as "urgent". "Constitución política de la república de Ecuador de 1998"; Crisis Group interview, political analyst, Quito, 11 June 2007.

¹⁸⁰ Presidential Decree no. 54, 23 January 2007, at www.presidencia.gov.ec.

¹⁸¹ TSE members are Jorge Acosta (PSP, president); Andrés Luque (PRIAN); Pedro Valverde (PSC); Andrés León (UDC); René Murguía (ID); Hernán Rivandeneira (PS-FA); and Elsa Bucaram (PRE).

¹⁸² To pressure Congress to approve the referendum, street protestors even broke into the Congress building after legislators had abandoned it on 30 January 2007.

¹⁷⁰ "Para la OEA el proceso electoral fue transparente y sin anomalías", *El Universo*, 16 April 2007. "Misión de Observación Electoral Consulta Popular. República de Ecuador: Informe Verbal del Jefe de Misión, Dr. Enrique Correa", OEA/OAS, 9 May 2007.

¹⁷¹ Correa's "motto" in his struggle with the opposition in Congress has been described as "I had better oust Congress before it ousts me". Crisis Group interview, political analyst, Quito, 26 March 2007.

¹⁷² *Vanguardia*, no. 66, 26 December 2006-1 January 2007.

¹⁷³ Crisis Group interview, Quito, political analyst, 27 March 2007.

¹⁷⁴ Crisis Group interview, Quito, political analyst, 28 March 2007.

¹⁷⁵ Crisis Group interview, Quito, leading member of MPD party, 11 June 2007.

¹⁷⁶ Crisis Group interview, political analyst, Quito, 28 March 2007. Correa's approval rating dropped slightly, to 69 per cent, in mid-March and rose in late April to 76 per cent. Cedatos-Gallup, 24 April 2007, www.cedatos.com.ec; "Cien días entre emergencias y consulta", *La Hora*, 24 April 2007; "Popularidad de Rafael Correa se ubica en 59%", *El*

On 13 February, 57 members of Congress, mainly from left-wing and indigenous parties¹⁸³ but also the opposition PSP of Lucio and Gilmar Gutiérrez and parts of the centre-right UDC, passed a resolution calling for the CA referendum but also stating that the CA would have to respect the result of the recent general election, meaning it would not be empowered to revoke the mandates of Correa and the legislators. Basing its decision on this resolution, the TSE gave a green light to the referendum that same day but changed the date to 15 April and requested that the two presidential decrees be merged.

The legislative resolution shows the erratic nature of the opposition's tactics. The PSP placed itself in a difficult position by supporting the referendum, despite previous opposition by some of its lawmakers to the government's proposal.¹⁸⁴ The PSC and PRIAN left the hall before the vote, arguing they would not support a "totalitarian model" inspired by Hugo Chávez but the next day announced they would participate in elections to the CA.¹⁸⁵ Correa made clear the congressional resolution would not stop the CA from revoking the mandates of elected officials, saying he would be the first to resign if requested,¹⁸⁶ and any attempt by "political mafias" to block an assembly with "full powers" (*plenos poderes*) under the pretext of safeguarding stability would be countered resolutely.¹⁸⁷ In response to the TSE's request for a single decree, the government issued no. 148, defining the rules to govern the assembly but without the article added by Congress on elected officials' mandates.¹⁸⁸

On 1 March, the TSE and its president, Jorge Acosta, ruled in favour of the referendum based on the latest presidential decree. This decision was supported by Magistrates René Maugé (ID), Hernán Rivandeneira

(PS-FA) and Elsa Bucaram (PRE). Acosta disregarded the line of his own party – the PSP – which had expected the new decree to be submitted to Congress for approval. The TSE action triggered a new crisis. On 5 March, the president of Congress' Constitutional Affairs Commission, Carlos Larreátegui (UDC) filed suit against the TSE at the Constitutional Court (TC). A day later, 57 opposition Congress members voted to remove Acosta, arguing the TSE had violated the constitution by agreeing to carry out the referendum solely on the presidential decree.¹⁸⁹ The Court then dismissed the 57 lawmakers. Correa backed the TSE, arguing that the legislators were trying to block the electoral process.¹⁹⁰ Acosta justified the decision by invoking the constitutional provision that during an electoral period, the TSE is the highest authority in the land.¹⁹¹

Although eight appeals (*recursos de amparo*) against the dismissals were submitted to courts of several small municipalities, almost no one defended the 57 or requested clarity on the grounds for the TSE decision.¹⁹² Government supporters rallied around the Congress building to prevent the expelled lawmakers from re-entering.¹⁹³ Correa attacked media outlets that reported critically on the events. On 9 March, the Ecuadorian Association of Newspaper Editors (AEDEP) issued a press release calling both the opposition's attempt to remove Acosta and the

¹⁸³ PRE, ID, RED, MPD, Pachakutik and Partido Socialista-Frente Amplio (PS-FA).

¹⁸⁴ PSP Congressman Fausto Cobo justified his party's support of the CA by saying, "we did this inside maneuver [in Congress], because we will not let Ecuador join the Iran-Venezuela-Nicaragua axis". "Oposición ecuatoriana participará en elecciones para Constituyente", *La Hora*, 16 February 2007.

¹⁸⁵ "Consulta va pero todos se quedan", *La Hora*, 14 February 2007.

¹⁸⁶ "Presidente de Ecuador pondrá su cargo a disposición de la Constituyente", *La Hora*, 14 February 2007.

¹⁸⁷ Correa claimed that the CA would allow the people to decide on radical change or more of the same, "the Febres Cordero, the Noboas, the Gutiérrez". "La asamblea sí podrá mandar 'a la casa' al Congreso, dice Correa", *El Comercio*, 15 February 2007.

¹⁸⁸ The decree re-affirms that the CA is given "full powers". Presidential decree no. 148, 27 February 2007, Article 1.

¹⁸⁹ "Congreso planteará inconstitucionalidad", *La Hora*, 3 March 2007. For Acosta's response, see "Tribunal analiza si admite demanda contra convocatoria a consulta", *La Hora*, 6 March 2007.

¹⁹⁰ The 7 March TSE decision to dismiss the 57 was supported by the executive. In an official press release, the government said it would "have the law observed and followed, therefore the resolution adopted by the plenary of the TSE, which establishes the...suspension of their political rights...", "Ecuador: destituyen a 57 diputados", BBC Mundo, 8 March 2007.

¹⁹¹ It is not clear when the electoral period started and hence whether the TSE correctly proclaimed itself to be acting as the highest authority in the country. Crisis Group interview, political analyst, Quito, 26 March 2007; "Tribunal Electoral destituye diputados que votaron cese presidente organismo", *La Hora*, 7 March 2007.

¹⁹² Crisis Group interview, political analyst, Quito, 28 March 2007.

¹⁹³ Osvaldo Flores (PRIAN), Henry Carrascal (PSP) and Carlos Larreátegui (UDC) were attacked by protesters outside a Quito hotel where they met after the police refused to let them enter the Congress building. "Estalla violencia", *La Hora*, 9 March 2007. Hugo Romero (PRIAN) and Edison Chávez (PSP) denounced police brutality when trying to enter the building on 13 March. "No se instala sesión parlamentaria", *La Hora*, 13 March 2007.

dismissal of the 57 unconstitutional. Correa subsequently adopted a more aggressive communication strategy.¹⁹⁴

Following the ousting of the 57, 21 deputies were sworn in on 20 March and seven the next day.¹⁹⁵ These 28 set up their own parliamentary group, Dignidad Nacional (DN),¹⁹⁶ which, though theoretically in the opposition, has given the administration a congressional majority by acting in de facto alliance with pro-government forces.¹⁹⁷

2. The push for the Constituent Assembly

Despite the first successes of Correa's "shock therapy" and his resounding referendum victory, the political struggle continued as attention turned to CA elections. The administration has sought to win a majority in the CA by following through on campaign pledges. This has included strong emphasis on social programs, urging establishment of two new provinces, increasing control of the banking sector and the Central Bank and broadening AP's social and political base.

On 23 April, the TC restored the 57 dismissed parliamentarians to office.¹⁹⁸ Congress, by then under government control, responded by dismissing all nine TC magistrates, arguing that their four-year term had expired.¹⁹⁹ After charges of sedition (contempt of the TSE) were filed against 24 of the 57 dismissed legislators, six of them sought political asylum in Colombia in late April. In early May, a group of dismissed lawmakers

clashed again with protesters near the Congress building in an unsuccessful effort to retake their seats.

President Correa subsequently sued newspaper director Francisco Vivanco, accusing *La Hora* of slander.²⁰⁰ In its editorial "Vandalismo oficial" of 9 March, it pointed to the president as the mastermind behind the violent street protests during the legislative-judicial standoff.²⁰¹ It did not present convincing evidence, however,²⁰² and Correa said he would continue to "file suits whenever they will be necessary in order to end the mediocrity and corruption of certain parts of the press".²⁰³

Although an official told Crisis Group the president only exercised his rights as a citizen,²⁰⁴ the measure was interpreted by many as an attempt to muzzle critics. Comparison was made to Hugo Chávez, whose government in May 2007 silenced Radio Caracas TV (RCTV), a private outlet known for anti-Chávez positions, by not renewing its licence. The Inter-American Press Society (SIP) criticised Correa's action as "clumsy",²⁰⁵ and the OAS said it "could be a disincentive to citizen participation out of fear of incurring a slander offence".²⁰⁶ However, Correa has continued to attack the media – in early June, for example, criticising TeleAmazonas for airing a video showing a compromising conversation between Economy Minister Patiño and Congress President Jaime Cevallos.²⁰⁷

The government's support base has steadily grown not least because of determination to confront the opposition and economic elites. According to an official, 210 social and political organisations and movements backed AP in June.²⁰⁸ Correa's emphasis on social issues – poverty alleviation, jobs and housing – was key to broadening his electorate in the second round.²⁰⁹ Since taking office,

¹⁹⁴ "Correa critica a la prensa pero la visita para promover su consulta", *El Universo*, 12 April 2007.

¹⁹⁵ After the dismissal of the 57 from the right-wing opposition, the centre-left and left-wing coalition that largely supports Correa became stronger. To a certain extent, it has been joined by the 28 deputies – twelve from the PSP, four from the PSC and twelve from PRIAN – who replaced the dismissed lawmakers. "Congreso posesiona a 21 diputados alternos e inicia sesión ordinaria", *La Hora*, 20 March 2007; "Congreso siguió sus sesiones con normalidad", *La Hora*, 21 March 2007.

¹⁹⁶ According to one source, the 28 deputies wore police uniforms when they were shuttled to Congress under heavy protection in the early morning of 20 March. Crisis Group interview, political analyst, Quito, 26 March 2007.

¹⁹⁷ The administration's control was first challenged in June, when the law on "financial justice" and several others were not passed. "Con alternos se reduce la oposición", *La Hora*, 22 March 2007; "Caudillismo ecuatoriano", *El País*, 22 March 2007.

¹⁹⁸ Judge Juan José Ramírez of Guayas province accepted their appeal and reinstated them. On 28 March, the TSE dismissed Ramírez by unanimous decision, ruling he had no jurisdiction.

¹⁹⁹ Congress appoints TC magistrates, a situation that has politicised the institution, Crisis Group interview, political analyst, 26 March 2007.

²⁰⁰ According to Articles 230 of the 1998 constitution, those who offend the president with threats or slander are liable to six months to two years of prison and payment of a fine. "Correa pide sanción para el diario La Hora por injurias", *El Universo*, 11 May 2007.

²⁰¹ It also accused the police of complicity, because they did not react. "Vandalismo oficial", *La Hora*, 9 March 2007.

²⁰² Crisis Group interview, RED legislator, Guayaquil, 11 June 2007.

²⁰³ "Gobierno de Ecuador pone en debate la libertad de expresión", *El Nuevo Diario*, 16 May 2007.

²⁰⁴ Crisis Group interview, ministry of internal and external security official, Quito, 8 June 2007.

²⁰⁵ Inter American Press Society communiqué, 11 May 2007.

²⁰⁶ "La OEA pidió al Ecuador abolir los artículos del desacato", *El Comercio*, 19 May 2007.

²⁰⁷ See below.

²⁰⁸ Crisis Group interview, ministry of internal and external security official, Quito, 8 June 2007.

²⁰⁹ Crisis Group interview, political analyst, Quito, 27 March 2007.

rapid implementation of promised social programs has been crucial to securing his approval ratings. Guided by constant interaction with social and indigenous organisations and opinion surveys indicating “bread and butter” issues are what matter most to voters,²¹⁰ the government knows social policy is basic to winning a majority in the CA.

According to the government, the 2007 social budget has been increased 15 per cent, to 6.3 per cent of GDP.²¹¹ In February, the administration doubled the Human Development Bonus subsidy (aimed at discouraging child labour) to \$30, benefiting 1.2 million people, and increased the Housing Bonus subsidy to \$3,600 from \$1,800 in urban areas and from \$500 to \$3,600 in rural areas. In March it allocated \$100 million for road building.²¹² Correa announced measures to help Ecuadorian migrants and decreed an emergency in agriculture, allocating new resources and allowing cheap urea imports. Small peasant communities were given ten more years to repay the National Development Bank (*Banco Nacional de Fomento*).²¹³ In June, he started the “Feeding Development” (*Nutriendo el Desarrollo*) program, to foster milk production by small producers and increasing their income by guaranteeing purchases by schools. The government has also re-affirmed commitment to a tax reform, whose key measure is reduction of VAT from 12 to 10 per cent, while replacing the lost income with taxes on the well to do.²¹⁴

In early March, Correa publicly asked banks to lower interest rates, reduce commissions and repatriate overseas accounts. He partially vetoed a law on “financial justice” (*ley de regulación al costo máximo efectivo del crédito*) in June because of amendments Congress added. It would require the Central Bank to set interest rates in accordance with market rates, while limiting banking commissions. It would also open the banking sector to foreign competition, which banking and business interests oppose.²¹⁵ Correa

has threatened to have his version of the law enacted by the CA,²¹⁶ which would give him greater control of the Central Bank and the banking sector.²¹⁷

The government has sought to create two new provinces, Santa Elena and Santo Domingo de los Colorados.²¹⁸ Santa Elena, a Pacific coast peninsula, voted in a referendum to separate from Guayas province. After his election, Correa somewhat reluctantly picked up the demand under street pressure and proposed a law to Congress in March. The Guayas authorities and many residents of the current province, as well as PRIAN, PSP and PSC, oppose the change.²¹⁹ The new pro-government majority, including parts of the Dignidad Nacional bloc, is divided, and a first vote on 13 June failed. The Santa Elena project, also approved by local referendum in 2006, has more support, including from the losing province (Pichincha) but is expected to encounter the same difficulties in Congress, and Correa has pulled back, saying the CA will be responsible for defining the new territorial order.²²⁰

While Correa has dominated the opposition in Congress, he may be less successful in the CA. UDC in particular but also PSC and PRIAN initially opposed that institution, saying it would foster instability if it followed the Venezuelan model.²²¹ They now recognise that this stance was political suicide and are preparing to fight for influence within it. PSC leaders declared the party would stand for election in order “to avoid that the

2007; “El Congreso de Ecuador aprueba una ley que abre el país a la banca extranjera”, *El País*, 15 June 2007.

²¹⁶ Facing difficulties in Congress over the laws on “financial justice”, “energy and hydrocarbon sovereignty” and “contraband control”, Correa announced that if AP and its allies won a majority in the CA, Congress would be closed and the constituent assembly would carry out legislative work. “Correa: Asamblea debe disolver el Congreso”, *El Universo*, 24 June 2007.

²¹⁷ Crisis Group interview, Guayaquil, 12 June 2007; Walter Spurrier, “Institucionalidad financiera”, typescript; and “Control sobre la banca”, *El Universo*, 21 May 2007.

²¹⁸ See Section III.C.3 below.

²¹⁹ The “Fuerzas vivas”, an anti-government group of Guayaquil businessmen, has been among the project’s strongest opponents. On 30 May 2007, the Guayas province assembly voted against it. Crisis Group interviews, citizens in the street and business journal editor, Guayaquil, 12 June 2007.

²²⁰ “Ahora Santo Domingo va al proceso de ser provincia 24”, *El Universo*, 8 June 2007; “Presidente firmó proyecto de provincialización de Santo Domingo”, *El Universo*, 7 June 2007; “No está claro provincialización de Santo Domingo de los Colorados”, *El Mercurio*, 18 June 2007.

²²¹ “La consulta es innecesaria: PSC”, *El Comercio*, 15 February 2007; “La constituyente va a ser otro Congreso”: Diego Ordoñez Pdt. (e) UDC”, *El Comercio*, 20 February 2007.

²¹⁰ Crisis Group interviews, citizens in the street and political analysts, Quito and Guayaquil, June 2007.

²¹¹ “El Gobierno aumentó la inversión social un 15% en 2007”, Presidencia de la República, 20 March 2007.

²¹² “Los 100 días de correa en el poder”, *El Telégrafo*, 23 April 2007.

²¹³ “Cien días entre emergencias y la consulta”, *La Hora*, 14 April 2007.

²¹⁴ Eduardo Cadena Dongilio, “Polémica reforma tributaria”, *Dinero*, 13 June 2007; Estuardo Salazar Caldas, “Reforma tributaria”, *Hoy*, 19 June 2007. The social benefits of the VAT reduction are somewhat limited, however, since food staples are VAT-exempt.

²¹⁵ “Congreso aprueba Ley de Justicia Financiera, pero no da paso a sugerencias del Ejecutivo”, *CRE Satelital Ecuador*, 14 June 2007; “Correa revisará cambios que efectuó Congreso a ley de ‘justicia financiera’”, *Terra.com*, 14 June

extreme left eliminates civic liberties”. Presidential candidate Cynthia Viteri has left but PSC leader Pascual del Cioppo expressed confidence in the party’s popular local figures, especially Guayaquil Mayor Jaime Nebot.²²² The PSP now hopes that if it does well in the delegate election, it can use the CA to pave the way for the comeback of former President Gutiérrez, who was stripped of his political rights after being ousted in 2005.

Parties and many social and political movements close to the government started on 5 May to collect signatures in support of national and provincial candidate lists for the CA election, scheduled for 30 September.²²³ Contrary to the expectations of government sources in Quito, who thought the battered traditional political parties would be unable to collect sufficient signatures to qualify for the CA election,²²⁴ the Electoral Court in June certified UDC, PSC, ID, PRIAN, PRE as well as PS-FA, MPD, Libertad, PSP and AP participation in the election of the 24 delegates to be chosen nationally.²²⁵ Former presidential candidates Noboa (PRIAN), Roldós (RED) and Gilmar Gutiérrez (PSP) as well as ex-energy and mining minister Alberto Acosta will stand on their parties’ or movements’ national lists. The final candidates list is to be published on 13 August but there are indications many political and social movements did not pass the threshold to present provincial candidates.

The administration is determined to get a CA majority. Correa said in June he would resign if he did not have between 80 and 100 of the 130 delegates. The PSP and PRIAN are the main challengers. Gilmar Gutiérrez, at the top of the PSP list, said that party will not, however, forge electoral or ideological alliances – a strategy that aims to repeat Correa’s 2006 success in distancing his movement from the traditional parties.²²⁶ According to Crisis Group sources, the PSP is likely to do well, as its

populism is attractive to many in the east and the highlands.²²⁷

Dissension within the indigenous movement contributed to Pachakutik’s defeat in the first round of the presidential election. The ethnic movements share Correa’s criticism of the traditional parties and desire to use the CA to enhance the political role of indigenous peoples. The president is popular with them not only for frequently speaking Quechua and wearing indigenous-style clothes,²²⁸ but also for advocating “explicit multicultural public policies” to improve their constituents’ conditions.²²⁹ However, a representative told Crisis Group that some elements of CONAIE believe he “stole their flag” and has made promises too big to keep. There is also some frustration with his refusal to give indigenous peoples direct representation in the assembly.²³⁰ Their support of the government in the CA will not be unconditional. They are also unlikely to support a referendum to approve a new constitution if it contains too many concessions to the right wing.²³¹

The broadcast in May and June of videos filmed on 12 February 2007 with a hidden camera and showing late-night, hotel-room conversations between then Economy Minister Patiño and first two members of the consulting firm Abadi & Company, then Congress President Jorge Cevallos (PRIAN) and Congressman Jaime Estrada (UDC), hurt administration credibility. The videos were leaked by a Patiño adviser, who said the first was to be used to blackmail bondholders.²³² A disillusioned leading member of the centre-left RED told Crisis Group Correa had defaulted on the promise to distance himself from the corrupt tactics of his predecessors.²³³

The first video linked Patiño to what may have been a foreign debt speculation scam. The government announced on 11 February it faced difficulty servicing the Global Bonds 2030 debt because social investment was a priority but it did so three days later. The threatened moratorium on servicing the debt appears to have affected the market price of the bonds, with the result that following payment

²²² “El PSC se aferra a la imagen de sus alcaldes para llegar a la asamblea”, *El Comercio*, 14 May 2007. “Disputa por Asamblea”, *La Hora*, 19 April 2007.

²²³ One analyst counts 57 social and political movements that attempted to qualify for the CA election. Fernando Buendía, “Renovarse o morir”, *Entre Voces*, June/July 2007, p. 51. The parties and movements must collect signatures of at least 1 per cent of the electorate to qualify.

²²⁴ Crisis Group interviews, ministry of internal and external security and national planning agency officials, Quito, 8 June 2007.

²²⁵ In addition to AP, approved political and social movements were RED, Pachakutik, Fuerza Ecuatoriana UNO, and Concertación Democrática.

²²⁶ “Disputa por Asamblea”, *La Hora*, 19 April 2007.

²²⁷ Crisis Group interviews, political analysts and high-ranking Quito municipality official, Quito, 26, 29 March and 11 June 2007.

²²⁸ “El Ecuador de Correa”, *El Tiempo*, 29 April 2007.

²²⁹ “Plan de gobierno del Movimiento PAIS 2007-2011”, op. cit.

²³⁰ Crisis Group interview, high-ranking CONAIE representative, Quito, 28 March 2007.

²³¹ Ibid.

²³² Hal Weitzman, “Ecuador Official Accused of Skewing Markets”, *Financial Times*, 12 July 2007.

²³³ Crisis Group interview, RED legislator, Guayaquil, 11 June 2007.

of the debt a few days later, the government may have benefited by as much as \$150 million and the Abadi Company by as much as \$100 million. Patiño stated he had the conversation filmed as part of a corruption investigation on how the external debt was illegally managed by his predecessors.²³⁴ The consulting firm representatives said the proposal discussed was a legitimate attempt to use credit default swaps to manage the debt.²³⁵

The second video showed the minister discussing plans for Congress's passage of a resolution on the CA referendum the next day with two members of the opposition.²³⁶ After its showing, PRIAN expelled Cevallos.²³⁷ Congress initiated two impeachment processes against Patiño and censured him on 13 July. Correa, after initially resisting the mounting pressure, reassigned him, in late July, to the newly created post of minister for the Pacific coast.

3. The Constituent Assembly

Correa wants "profound, radical and rapid" change²³⁸ through a CA with "full powers", including to revoke elected officials' mandates and call new local and national elections. The government hopes it will quickly write a new constitution and so avoid disenchantment among its followers.²³⁹ Having closely examined experiences in Ecuador in the late 1990s and abroad, Correa aims to avoid a lengthy review of a large number of proposals before the CA elaborates a final draft that must be agreed by an absolute majority.²⁴⁰

Of the 130 delegates to be elected on 30 September, 100 will be chosen proportionally in provincial districts,²⁴¹ 24 will be elected nationally and six by Ecuadorians living abroad.²⁴² To present candidates, parties or movements must prove support of at least 1 per cent of the voting district's eligible voters. State funding will be provided to all campaigns to reduce the influence of special interests but the TSE has money only to cover mass media advertising,²⁴³ so established parties with resources will have an edge. The CA has a tight schedule. It opens on 31 October, nine days after TSE announcement of final election results. Six months are foreseen for business, including seven days to adopt internal rules, with a possible extension for a further 60 days. Decisions will require an absolute majority, the votes of 66 delegates. Once the final draft is approved, the TSE will have 45 days to prepare a ratification referendum.²⁴⁴

To speed the process, Correa gave the National Council for Higher Education (*Consejo Nacional de Educación Superior*, CONESUP) responsibility to prepare a draft constitution as the basis for opening discussion. CONESUP's board of eight jurists and the government delegate, Paula Romo, are to compile and analyse all proposals made by parties, social movements, labour unions, private and public institutions and individual citizens as well as the executive, before submitting that draft. The deadline was 5 May for proposals, which are available online.²⁴⁵ While this is an efficient way to deal with a large number of ideas, it is uncertain what criteria the panel of experts will use for evaluating them.

The proposals generally touch on four large issues: fundamental rights and liberties; political reform; a new territorial order; and a new economic model. Crisis Group sources indicate there appears to be broad consensus for maintaining the fundamental rights and liberties in the

²³⁴ "Ministro de Economía muestra 'Pativideos'", *CRE Satelital Ecuador*, 24 May 2007; "'Pativideos' develaron que ex funcionarios de Gobiernos anteriores fueron 'tenedores de deuda'", *Ciudadanía Informada*, 24 May 2007; "El video de Patiño agrega nombres a pugna por la deuda", *El Universal*, 25 May 2007.

²³⁵ "Ecuador Official Accused of Skewing Markets", op. cit.

²³⁶ "Divulgan segundo video grabado ilegalmente en el que aparece el Ministro de Economía de Ecuador", *El Tiempo*, 12 June 2007.

²³⁷ "Otro vídeo genera más polémica política", *El Comercio*, 19 June 2007.

²³⁸ Crisis Group interview, political analyst, Quito, 27 March 2007.

²³⁹ Crisis Group interview, ministry of internal and external security official, Quito, 8 June 2007.

²⁴⁰ Ibid. Foreign experiences studied include Venezuela, Colombia and South Africa as well as Bolivia's present one. In a recent interview, Correa said, "our project is not called Bush's or Chávez's...what we will do is follow good practices". "Ecuador dijo si al cambio", *El Telégrafo*, 15 April 2007.

²⁴¹ Guayas (eighteen); Pichincha (fourteen); Manabí (eight); Azuay and Los Ríos (five each); Chimborazo, Cotopaxi, El Oro, Loja, Esmeraldas and Tungurahua (four each); Bolívar, Cañar, Carchi and Imbabura (three each); Galápagos, Morona, Napo, Orellana, Pastaza, Sucumbíos and Zamora (two each).

²⁴² Two CA delegates will represent Ecuadorians in the U.S. and Canada two those in Europe and two those in Latin America.

²⁴³ The TSE established an estimated state budget of \$49 million for the elections on 30 September and an additional \$60 million to finance advertisement spots (press, radio and television) for all candidates. This will cover 60 per cent of candidates' authorised campaign expenses. They will have to cover other expenses, such as flyers, brochures, posters and transportation, themselves. "Estado no financiará totalmente a candidatos", *La Hora*, 18 May 2007.

²⁴⁴ Presidential Decree no. 148 of 27 February 2007.

²⁴⁵ See www.conesup.net/sugasamblea.php.

1998 constitution, as well as on need for political party reform (by introducing primaries, for example); depoliticisation of entities such as the public prosecutor, the comptroller general and the courts; and enhanced citizen representation in Congress, which could mean both more equal voting districts and establishment of a senate.²⁴⁶ Though Correa has not yet said he favours it, an immediate, new presidential election is expected to be a highly divisive issue.

There is less agreement about the new territorial order. Some proposals would replace the existing 22 provinces (24 if Santa Elena and Santo Domingo de los Colorados are created) with five or six regions. The basic considerations are the inefficiency of local government and the desire to enhance regional autonomy. The new economic model, which involves among other issues defining the state's larger role and deciding whether to introduce another currency parallel to the dollar or even end dollarisation, will be highly controversial because it goes to the heart of the Correa administration's political project.²⁴⁷

IV. CHALLENGES AND RISKS

After just over six months in office, President Correa and his government need to address urgently a number of challenges. Correa ably used his extensive political capital during the honeymoon period. The hopes of a large majority of Ecuadorians for profound change after years of frustration and instability have been encouraged by a frontal attack on discredited parties and state institutions as well as the media and the rapid implementation of social programs for those most in need. Correa is perceived by many citizens as a "friend", as "one of their own".²⁴⁸ Even controversial measures such as creation of Santa Elena province and the video scandal have not much affected his standing.²⁴⁹ He has successfully sold the CA as the vehicle for fundamental reform.

It is by no means certain, however, that the CA can accomplish its goals. Its legitimacy could be undermined if the proposals submitted to CONESUP are not adequately reflected in the initial draft document. The lack of a mechanism to guarantee representation of indigenous peoples and Afro-Ecuadorians is also problematic. The assembly may deadlock if the opposition parties, in particular PSP and PRIAN but also PSC, ID and UDC, obtain enough seats to block Correa's reform plans. Even if they play under the TSE's rules for campaign spending, parties such as PRIAN and PSC have the funding and solid structures to do well in the election of delegates, and if the assembly does not pass major measures, disenchantment with Correa could develop quickly.

Correa's "citizen revolution" is already being heard of less often, as power is becoming ever more concentrated in the person of the president. Using his high speed "shock therapy", Correa has out-manoeuvred the political opposition and establishment but has not advanced much in strengthening alliances with the social and political movements.²⁵⁰ This means that there is no effective opposition but also that there are no allies whose constructive criticism can induce course corrections in government policy.²⁵¹ The video scandal has alienated some of the pro-Correa upper middle class and intelligentsia, which

²⁴⁶ Crisis Group interview, national planning agency official, Quito, 8 June 2007.

²⁴⁷ Ibid.

²⁴⁸ Crisis Group interview, political analyst, Quito, 27 March 2007.

²⁴⁹ Crisis Group interviews, citizens in the street, Quito and Guayaquil, March and June 2007.

²⁵⁰ Franklin Ramírez, "Sujetos a Correa", *Entre Voces*, June/July 2007, pp. 34-35.

²⁵¹ Crisis Group interview, political analyst, Quito, 11 June 2007.

worry his administration could end up using the same disreputable tactics as its predecessors.²⁵²

While the government clearly perceives its political project as long-term, there are still no indications of its plans once a new constitution is in place, presumably in mid-2008. It is focusing all energies on making the CA happen, keeping the opposition at bay and maintaining popular approval, in good part through social spending. Some officials acknowledge the risk in waiting too long before transforming AP into a political party.²⁵³ There is a fundamental question whether the rule of law, still in shambles, will be upheld effectively once the new constitutional framework is in place.

High oil revenues and the money previously channelled into the Fund for Stabilisation, Investment and Reduction of the Public Debt (*Fondo de Estabilización, Inversión y Reducción del Endeudamiento Público*, FEIREP) are paying for the government's social programs.²⁵⁴ But PetroEcuador's production is falling, and other production is flat. Oil money, in any case much less than Venezuela's, even per capita, is not unlimited. The abolition of FEIREP in 2005 when Correa was economy minister has made Ecuador extremely vulnerable to fluctuations in international oil prices.²⁵⁵ The possibility of eventual default on the \$16.4 billion foreign debt is high.²⁵⁶ Correa announced Ecuador was severing IMF ties in April 2007 and had made its last payment to the body, though in May, Minister Patiño denied Ecuador had withdrawn.²⁵⁷ Should it default on its debt, the country would likely be subjected to hundreds of lawsuits and find its ability to do business severely hampered.²⁵⁸

V. CONCLUSION

President Correa and his left-wing administration are convinced they are the catalyst for profound change that will not only end the last decade's vicious cycle of instability but also provide a more just future for citizens. This conviction is based primarily on the president's record-high approval rating and proven talent to communicate with the poor and working class. Its leaders see themselves as a progressive, well-educated elite and believe the era of the old, discredited power structures, in particular the traditional parties, has ended. Correa's "shock therapy" during his first months in office has produced government control of Congress, the Electoral Court, parts of the judiciary, other state institutions and the banking sector and opened the way to a CA, his primary goal.

The path to the constituent assembly, however, has come at the expense of the constitution and the rule of law. The government committed serious mistakes, such as the hidden deals evidenced in the videos scandal. Using questionable tactics – even if more selectively – in order to end similar behaviour by its opponents with the goal of establishing democratic stability is a dangerous game. The president's hostility to the media and his legitimate but also reckless social spending are further causes for concern.

The Correa administration thus may be less of a break with the past than it claims. Since the mid-1990s, when political, institutional and economic instability set in, Ecuador has witnessed a growing trend toward undermining the rule of law, and unconstitutional and corrupt behaviour by lawmakers, courts, state institutions, political parties and social movements, including the indigenous sectors. Presidents before Correa, such as Bucaram and Lucio Gutiérrez, came to power by presenting themselves as untainted "anti-party and anti-system outsiders" but ended up acting and governing in the old way. They were ultimately forced from office and added a new layer to the country's growing scar tissue of unstable governance.

After winning the first battles against the opposition, the Correa administration is almost entirely focused on the CA, perceived as the first step in a long process of political and socio-economic change. The better part of government action and policy is geared to winning a majority in the assembly. In the process the president is distancing his administration from its base in the social and political movements. While a national development plan is being elaborated with citizen participation, there are hardly any other signs the government is preparing for the challenges

²⁵² Crisis Group interviews, RED legislator and business journal editor, Guayaquil, 11 June 2007.

²⁵³ Crisis Group interviews, ministry for internal and external security and national planning agency officials, Quito, 8 June 2007.

²⁵⁴ FEIREP was funded by the differential between the set and real international price of oil and used to finance education and health programs as well as to protect Ecuador against fluctuations in those prices.

²⁵⁵ Crisis Group interview, political analyst, Quito 11 June 2007.

²⁵⁶ In March 2007 the government ordered banks to repatriate about \$2 billion, which could be an effort to protect liquid assets from creditor claims in the event of default. Kenneth S. Levine, "Arming for an Ecuador Default", *LatinFinance*, 1 April 2007.

²⁵⁷ "Ecuador Pays off IMF Debt, Says will Sever Ties with Institution", Reuters, 15 April 2007; "Ecuador Has No Plans to Quit IMF", Reuters, 16 May 2007.

²⁵⁸ Ecuador would also have difficulty floating any future bonds.

that will emerge following enactment of the new constitution, or even during the drafting process.

Correa is certainly correct that a very large percentage of the population is in desperate need of better living conditions – what he refers to as the country’s “social debt”. The structural adjustment programs of the past disappointed in both growth and social distribution. Delivering real economic development after a quarter-century of stagnation and instability is a huge challenge. A more competitive economy that can move beyond primary commodity exports is essential. This requires reducing stifling corruption and making the necessary investment in human capital in order to diversify.²⁵⁹

Despite setbacks, parts of the opposition, notably PSP and PRIAN, will almost certainly be important in the CA and beyond, making the government’s life difficult. Other actors, such as the military and the economic elite, above all in Guayaquil, will show their teeth if the new

constitution jeopardises their interests. The social and political movements and the middle class, partly estranged by government mistakes, could withdraw support if bread and butter demands are not met and the government is perceived to compromise too much. Like many countries dependent on oil, a major price drop would create dire problems for Ecuador. To prepare, the administration should act decisively against corruption and reinforce the rule of law as part of an effort to generate investment. To break the destructive spiral of instability, it needs to democratise and institutionalise its AP movement. Finally, Correa must ensure a transparent and fair CA process, seek consensus on key points of the constitutional framework and elaborate an economically sustainable National Development Plan 2007-2011 with broad citizen participation.

Bogotá/Brussels, 7 August 2007

²⁵⁹ Transparency International’s 2006 Corruption Perceptions Index ranked only Haiti as more corrupt in Latin America.

APPENDIX A

MAP OF ECUADOR



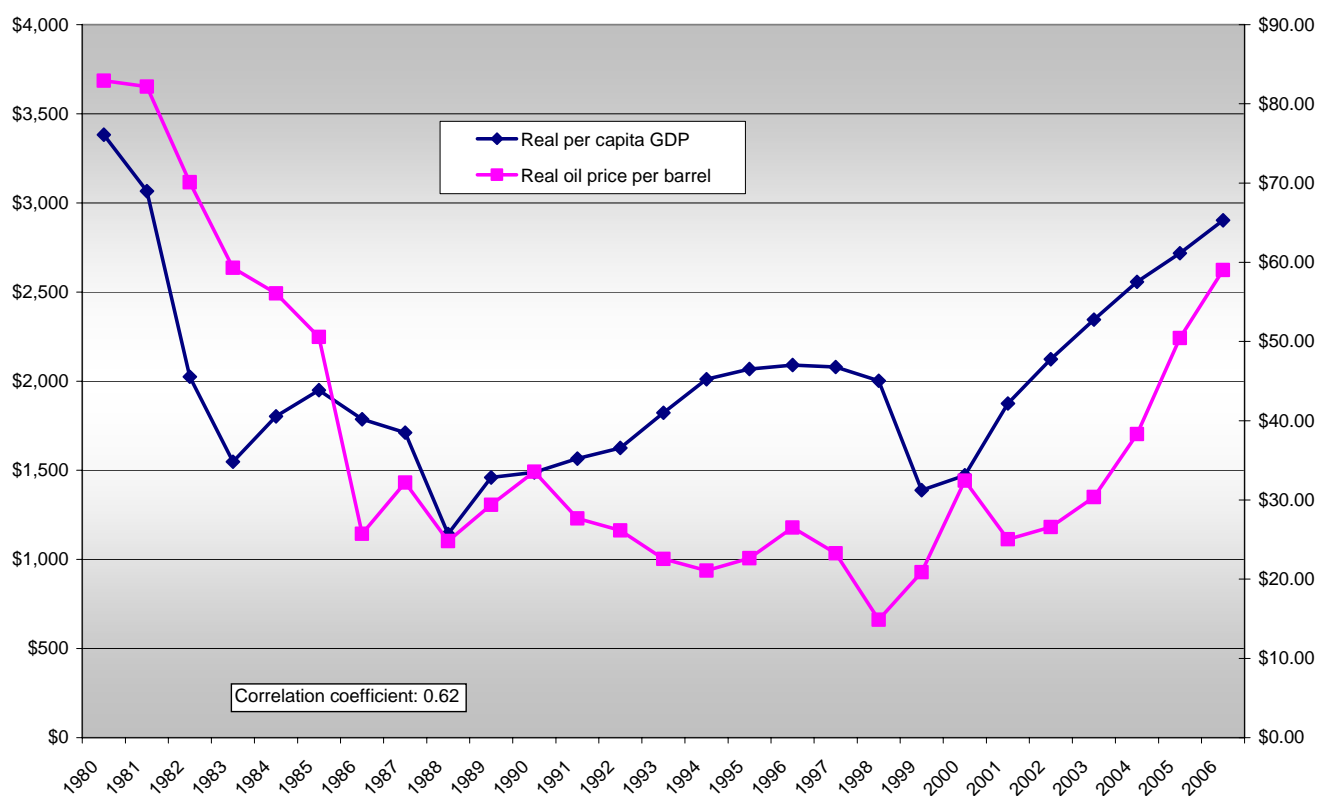
APPENDIX B

GLOSSARY OF ACRONYMS

AD	Alternativa Democrática (Democratic Alternative)
AP	Alianza País (Country Alliance)
ATPA	Andean Trade Preference Act
CA	Constituent Assembly
CONAIE	Confederación de Nacionalidades Indígenas de Ecuador (Confederation of Ecuador's Indigenous Nationalities)
CONESUP	Consejo Nacional de Educación Superior (National Council for Higher Education)
FARC	Fuerzas Armadas Revolucionarias de Colombia (Revolutionary Armed Forces of Colombia)
FEIREP	Fondo de Estabilización, Inversión y Reducción del Endeudamiento Público (Fund for Stabilisation, Investment and Reduction of the Public Debt)
FOL	Forward Operating Location
FTA	Free Trade Agreement
ID	Izquierda Democrática (Democratic Left)
MPD	Movimiento Popular Democrático (Popular Democratic Movement)
MUPP-NP	Movimiento de Unidad Plurinacional Pachakutik-Nuevo País (Movement of Plurinational Unity Pachakutik-New Country)
OCF	Oleoducto de Crudos Pesados (Heavy crude pipeline)
PRE	Partido Roldosita Ecuatoriano (Ecuadorian Roldosista Party)
PRIAN	Partido Renovación Institucional Avanzada Nacional (Institutional Renewal National Avantgarde Party)
PSC	Partido Social Cristiano (Social Christian Party)
PS-FA	Partido Socialista-Frente Amplio (Socialist Party-Broad Front)
PSP	Partido Sociedad Patriótica (Patriotic Society Party)
RED	Red Etica y Democracia (Ethics and Democracy Network)
TC	Tribunal Constitucional (Constitutional Court)
TSE	Tribunal Supremo Electoral (Electoral Tribunal)
UDC	Unión Demócrata Cristiana (Christian Democrat Union)
UICN	Unión Internacional para la Conservación de la Naturaleza (International Union for Nature Conservation)

APPENDIX C

ECUADOR'S REAL PER CAPITA GDP AND A MEASURE OF THE OIL PRICE USING THE U.S. IMPORTED REFINER'S COST 1980-2006



SOURCES: GLOBAL INSIGHT; U.S. ENERGY INFORMATION ADMINISTRATION; CRISIS GROUP CALCULATIONS

APPENDIX D

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Crisis Group's approach is grounded in field research. Teams of political analysts are located within or close by countries at risk of outbreak, escalation or recurrence of violent conflict. Based on information and assessments from the field, it produces analytical reports containing practical recommendations targeted at key international decision-takers. Crisis Group also publishes *CrisisWatch*, a twelve-page monthly bulletin, providing a succinct regular update on the state of play in all the most significant situations of conflict or potential conflict around the world.

Crisis Group's reports and briefing papers are distributed widely by email and printed copy to officials in foreign ministries and international organisations and made available simultaneously on the website, www.crisisgroup.org. Crisis Group works closely with governments and those who influence them, including the media, to highlight its crisis analyses and to generate support for its policy prescriptions.

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