Ecuador's Presidential Election: Background on Economic Issues

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Introduction

Voters in Ecuador face a clear choice on November 26 in the second and final round of the presidential election. On one side is the billionaire banana magnate Alvaro Noboa, the country's richest man, who favors a continuation of current economic policies and further economic integration with the United States; on the other side is Rafael Correa, a left-of-center economist who promises to break with the policies of the IMF and World Bank, and opposes a new commercial treaty with the United States.

In addition to the polarized programs of the candidates, there is a crisis of legitimacy of the political system. The country has had eight presidents in the last 10 years. The traditional political parties are marginalized from this presidential election. Noboa created his own party in 2002 – the Institutional Renewal Party of National Action (Partido Renovador Institucional de Accion Nacional or PRIAN) and Correa is running with the newly formed party Alianza PAIS— Proud and Sovereign Nation Alliance (Patria Altiva I Soberana) but without any Congressional candidates: he proposes to create a constitutional assembly to rewrite the constitution and reform existing political institutions, which are viewed by many as corrupt and inept. Recent polls[1] show a tight race for the runoff election on Sunday November 26.

Economic issues, including trade, economic relations with the United States and multilateral institutions, and future economic stability have played a role in this electoral campaign. This paper looks at Ecuador's economy and some of the economic issues that are relevant to the election.

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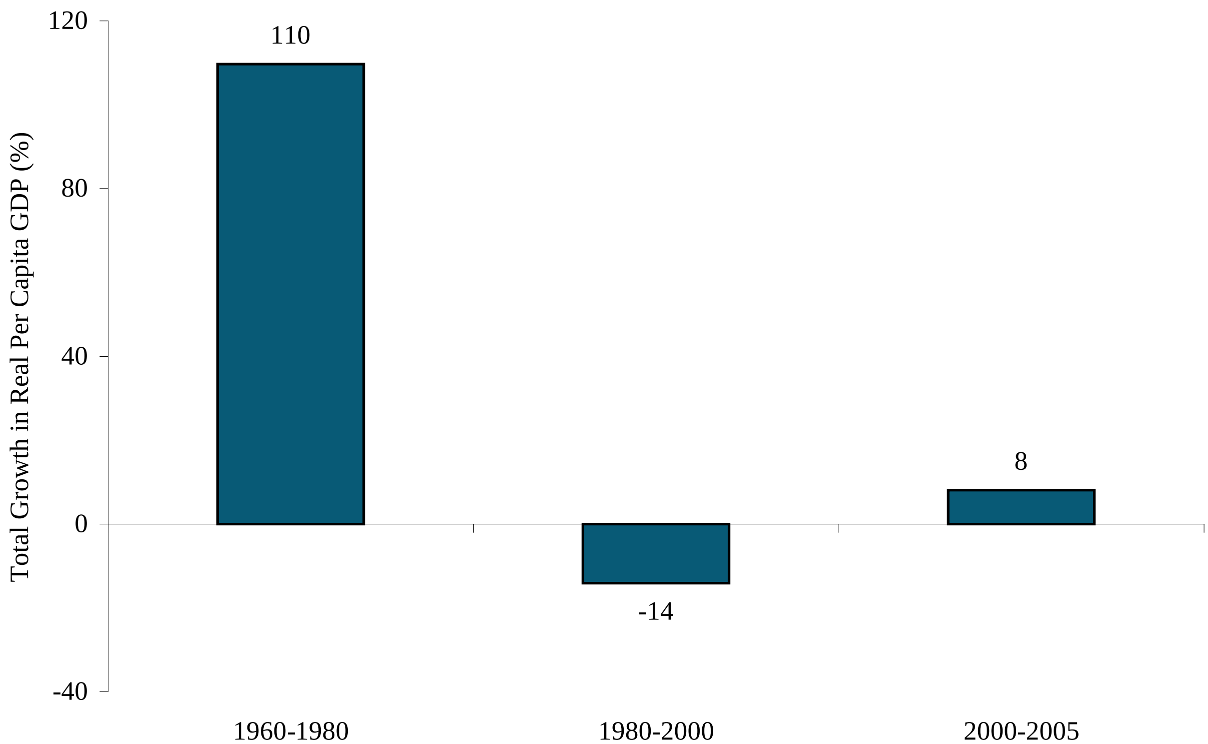
[1] For example, Cedatos-Gallup poll conducted Nov.11-13 showed a statistical tie (for a summary of polls on Ecuador, see http://www.angus-reid.com/polls/index.cfm/fuseaction/searchSimpleResults/iw/1/keyword/correa%20and%20noboa).

Ecuador's Long-Term Economic Growth Failure: the Country's Biggest Economic Problem

The growth of GDP per capita[2] in Ecuador over the last 25 years has been negative. Figure 1 shows the collapse of economic growth over the 1980-2000 period: GDP per capita actually fell by 14 percent. This is a disastrous economic failure, about equal to what happened to Africa during this period. It is also worth comparing it to the 1960-1980 period, when Ecuador's economy grew by 110 percent per capita.

FIGURE 1
Percent Growth in Real Per-Capita GDP in Ecuador



Sources: Penn World Tables (6.2 version); IMF World Economic Outlook (September 2006); and authors' calculations.

It is important to recognize that the economic growth failure of the last 25 years, and not any changes in the distribution of income, is responsible for the high levels of poverty that Ecuador suffers from today. If the economy had simply continued to grow at its pre-1980 rate, the country would have average living standards comparable to Chile. Also, Ecuador's pre-1980 growth rate was not unusually high for a developing country – South Korea grew about twice as fast and Taiwan nearly three times as fast during this period. So the 1960-1980 period provides a reasonable benchmark to compare the last 25 years, as well as for future growth targets.

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[2] Per capita GDP is used here because it is a better indicator of the change in the country's average living standards than GDP; if GDP grows only because of population growth, then the population as a whole is not necessarily better off. All numbers here are real – adjusted for inflation.

As a result of this growth failure, Ecuador's income per person is only $5,392[3] today. It is also much more difficult, and often politically impossible, to improve the distribution of income in the absence of economic growth. When the economy is not growing, it means that any gains for the poor must be directly at the expense of the middle and upper classes.

Ecuador's growth failure mirrors what happened in the region: Latin America's regional per capita GDP grew by 82 percent per capita from 1960-1980, but only 13 percent in the (longer) period from 1980-2005. This is the worst 25-year economic performance in the region for more than a century. Rafael Correa, who received his Ph.D in economics from the University of Illinois in Urbana, is the eleventh in a series of left-populist presidential candidates in the last eight years in Latin America who have campaigned against the "neoliberal" economic policies of this period, as they are commonly known in the region. Seven of these candidates won[4], and the other three (Costa Rica, Peru, Mexico) have come close to winning.

In the most recent period, since 2000, Ecuador has done better than the regional average, growing by a total of 8 percent[5] per capita for the years 2000-2005, and an additional 3 percent expected for this year. This has not, however, been sufficient to stem voter discontent with the government, and as noted, the established political institutions and parties remain discredited. There are several reasons that the improvement in economic performance does not seem to have stabilized the country's politics.

First, the economic growth since 2000 has not been enough to make up for the decline in per capita income over the preceding two decades. So the average person is still worse off than they were 25 years ago, in terms of per capita income.

Second, the government has cut social spending drastically since 1993. This is shown in Table 1. As a percentage of GDP, it fell from a high of almost 9 percent of GDP in 1993 to 4 percent in 2000. Since 2000 it went back up to 6.6 percent of GDP in 2004[6], but even in real spending per person it remains below its 1993 levels.

Third, poverty is widespread and unevenly distributed geographically, and is concentrated among the indigenous population. The poverty rate for the entire population reached 45 percent in 2001[7], having climbed up by a third since 1995.[8] For indigenous people, the rate is 87 percent, and 96 percent for those living in the rural highlands. Social indicators also vary dramatically by ethnicity and geography. Indigenous Ecuadorians (age 30-34) have 6.9 years of formal education, as compared to 9.6 years for the rest of the population. For non-indigenous children ages five to

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[3] This is a purchasing power parity (PPP) measure, which adjusts for international price differences and is generally better for international comparisons; in current dollars, per capita GDP is $2760.

[4] These were Néstor Kirchner of Argentina (2003), Lula da Silva of Brazil (2002), Lucio Gutiérrez of Ecuador (2002), Tabaré Vázquez of Uruguay (2005), and Hugo Chávez of Venezuela (1998 and 2000), and Daniel Ortega of Nicaragua (2006)

[5] There are some differences between different data sets, and IMF WEO (September 2006) data puts the increase at 23 percent per capita (PPP). The Penn World Tables are used as the main data source here because it has a consistent data set from 1960-2004.

[6] Latest numbers available.

[7] World Bank (2004), "La Pobreza en el Ecuador. Evaluacion y Agenda de Politicas," Washington, DC. Available online at: http://www.mef.gov.ec/docs/Presentacion,%20La%20pobreza%20en%20Ecuador%20(BM).pdf

[8] Address by Stanley Fischer, "Ecuador and the IMF", Hoover Institution Conference on Currency Unions on May 19, 2000: http://www.imf.org/external/np/speeches/2000/051900.htm#P9_23.

TABLE 1
Ecuador: Social Spending, 1990-2004

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Social spending per capita															
(in constant 2000 US$)															
Total	100	90	97	115	79	82	82	67	72	55	50	77	74	78	92
Education	38	33	33	46	33	37	38	30	36	28	22	30	38	33	40
Health	18	18	22	20	9	13	12	10	11	9	8	12	14	15	17
Social Security	43	39	42	48	30	28	30	24	23	18	18	27	19	27	32
Housing	0	0	0	1	7	4	2	3	3	1	2	8	3	3	3
Total social spending															
(in % of GDP)															
Total	8.0	7.0	7.4	8.9	5.9	6.2	6.2	4.9	5.3	4.4	4.0	5.9	5.6	5.9	6.6
Education	3.0	2.6	2.5	3.5	2.5	2.8	2.9	2.2	2.7	2.2	1.8	2.3	2.9	2.5	2.8
Health	1.5	1.4	1.7	1.5	0.7	1.0	0.9	0.8	0.8	0.7	0.6	0.9	1.1	1.1	1.2
Social Security	3.5	3.0	3.2	3.7	2.2	2.1	2.2	1.7	1.7	1.4	1.4	2.1	1.4	2.0	2.3
Housing	0.0	0.0	0.0	0.1	0.5	0.3	0.2	0.2	0.2	0.1	0.1	0.6	0.2	0.2	0.2
Total social spending as % of total public spending															
Total	43.9	41.7	43.5	53.5	38.3	29.2	31.6	23.6	26.3	17.1	19.0	22.7	24.6	25.8	27.3
Education	16.8	15.3	14.7	21.4	16.1	13.1	14.6	10.6	13.3	8.7	8.5	9.0	12.6	10.9	11.7
Health	8.1	8.2	10.0	9.3	4.4	4.5	4.7	3.7	3.8	2.7	3.1	3.4	4.7	5.0	5.1
Social Security	19.0	18.0	18.7	22.3	14.3	9.9	11.4	8.3	8.2	5.5	6.7	7.9	6.3	9.0	9.5
Housing	0.1	0.1	0.1	0.5	3.4	1.6	0.9	1.0	1.0	0.3	0.6	2.5	1.0	0.9	1.0
Fiscal Balance (Non Financial Public Sector)															
(in % of GDP)															
Overall	0.5	-0.6	-1.1	-0.6	-0.2	-1.3	-2.8	-2.1	-5.2	-4.9	1.4	0.0	0.8	1.7	2.3
Primary	6.9	5.3	3.6	3.6	3.4	2.6	1.1	2.1	-1.0	2.2	8.0	4.7	4.3	4.7	4.9

Source: Economic Commission for Latin America and the Carribbean (ECLAC) eighteen, 73 percent attended school and did not work; for indigenous children it is 57 percent, with 28 percent working and a third not attending school at all. Child mortality among indigenous people is twice the rate of non-indigenous children, and child malnutrition is 59 percent, compared to 26 percent for non-indigenous.[9]

The organization and demands of indigenous groups to overcome their social and political exclusion has been a regional phenomenon – the election of Evo Morales as the first indigenous president of Bolivia last December being the most prominent example. As a result of these factors and other political changes sweeping the region, as well as the widely perceived corruption of elected and appointed officials, the economic growth of the last few years in Ecuador has not been enough to restore confidence in the political system.

Economic Crisis in Ecuador: Could the 1990's Crisis Be Repeated?

As in almost every Latin American election in recent years where a left-of-center candidate has challenged the economic and political status quo, fears of economic crisis have been part of the campaign against the left candidate. Perhaps the most famous example was the Brazilian presidential election of 2002, where a financial crisis erupted during the campaign when leftist Lula Da Silva of the Workers' Party pulled ahead in the polls. But the markets soon calmed after the election, and fears of economic crises upon the election of left candidates in recent years have generally proven to be without foundation.

Nonetheless, memories of the 1998-2000 economic crisis in Ecuador, one of the worst in the country's history, are still fresh. And candidate Rafael Correa has been criticized for his statements about renegotiating the country's debt, as well as his disputes with the World Bank and IMF. So the issue of economic stability in the event of a left victory is one that may play a role in this election.[10]

In Ecuador, the economic situation today is very different from that of the late 1990s, and therefore an economic crisis is unlikely, regardless of who wins the November 26 election. The late 1990s crisis was primarily a result of external factors that are not present today and are not likely to be repeated in the near future. As happened with other countries in Latin America, Ecuador attracted a lot of foreign capital and experienced a credit boom between 1993 and 1995, but this was reversed with the "Tequila crisis" in Mexico in 1995. The Mexican peso crisis, and the outflow of capital that occurred there and elsewhere, was mainly the result of an increase in U.S. short-term interest rates (from 3 to 6 percent for 1994-1995), which drew capital out of Mexico and other countries. The monetary authorities in Ecuador responded to the peso crisis by raising interest rates above 50 percent in 1995 (almost 30 percent real interest rates) and thereby keeping the currency from crashing. Growth fell to 1.7 percent for 1995 and the financial system was strained. The conflict with Peru in 1995 brought additional economic stress.

[9] World Bank, "Indigenous Peoples, Poverty and Human Development in Latin America: 1994-2004;" May 18, 2005.
[10] This issue may resurface prominently in the remaining days of the campaign. " 'We would expect Noboa to re-instigate the `fear factor' against Correa, moving away from personal attacks and focusing more on the threats of his policies for the country's stability,' wrote Marjorie Hernandez, a Latin America debt analyst with HSBC Securities Inc. in New York, in a report today." (Lester Pimental and Helen Murphy, "Ecuador's Bonds Fall on Correa's Restructure Pledge, Oil Prices," Bloomberg:
http://www.bloomberg.com/apps/news?pid=20601086&sid=alieIPPMcNP0&refer=latin_america

Ecuador's economy managed to make it through the Asian financial crisis that began in August 1997, but suffered from other major shocks that occurred at the same time: the floods from El Nino caused enormous economic damage in late 1997 and 1998, with estimates of crop and infrastructure damage as high as 13 percent of GDP.[11] But the Asian financial crisis spread, first to Russia and then to Brazil and Argentina, and Ecuador was dragged down with it. Like Argentina, Ecuador faced increasing interest costs, which also drove up the current account.

This is shown in Figure 2. Interest payments increased from 4.2 percent of GDP in 1998 to 7.1 percent in 1999. The current account deficit peaked at 9.3 percent of GDP in 1998 (most of the public debt was dollar-denominated). The government responded by continuing to cut social spending: by 2000 it was just 43 percent of its real 1993 levels, but this did not stem the crisis. The economy was also hit by the collapse of oil prices in 1998, which cut government revenue by 14 percent.[12] The currency collapsed, which put increasing stress on a highly *de facto* dollarized financial system (where many receipts were in sucres but payments in dollars). The result was a severe economic crisis, with GDP declining by 6.3 percent in 1999, and inflation reaching 96 percent in 2000. There were freezes on bank deposits, financial institutions closed, and employment plummeted, prompting the largest wave of emigration in Ecuador's history.[13] The crisis also led to a default on the public debt in 1999.

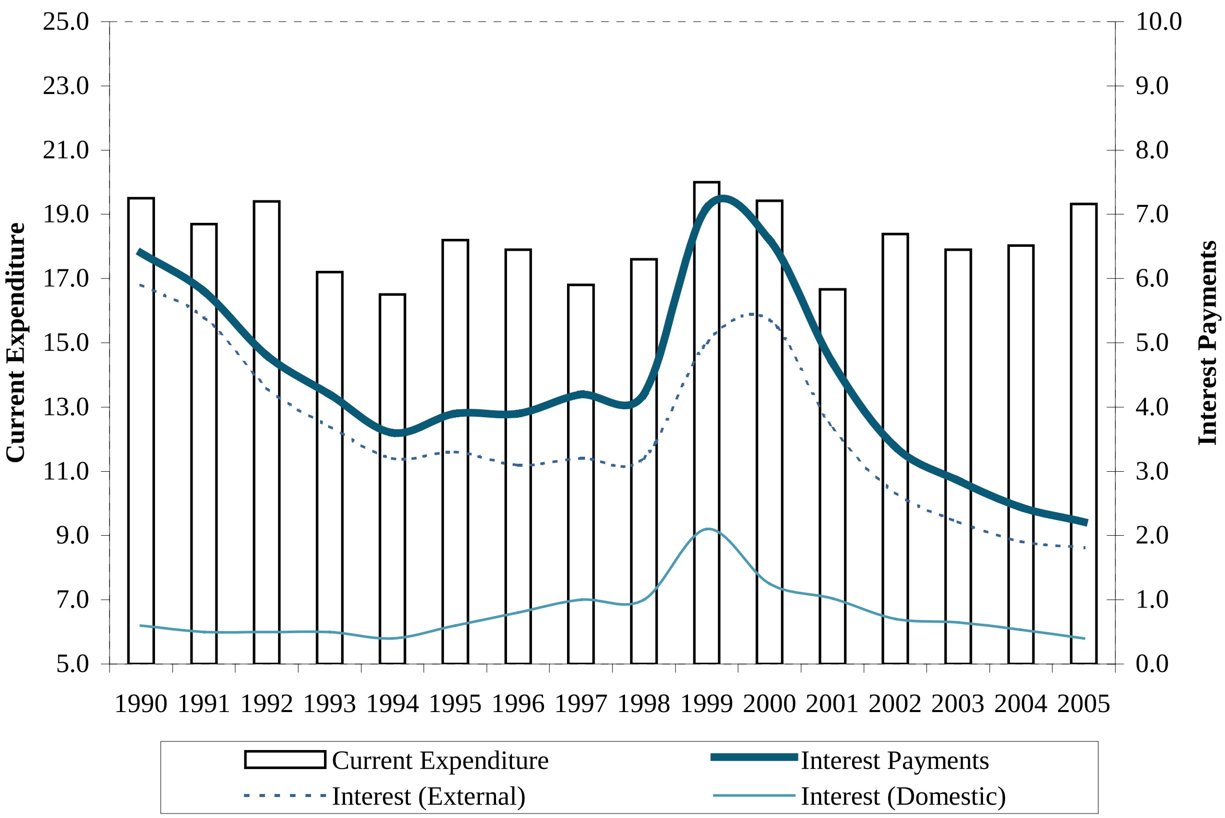
The question with regard to this election is whether the economy remains vulnerable to crisis in the event that, for example, the policies or president of a new government are not favored by the financial sector, either nationally or internationally. This seems very unlikely. The late 1990s crisis was a result of a set of external shocks, combined with weaknesses in the country's financial system. While such external shocks – e.g., rapidly rising interest payments due to crises in the international financial system – are possible (although not likely), they would not be brought on by the election in Ecuador. The same is true for the 1995 El Nino and the collapse of oil prices – anything is possible, but again such external events are not related to electoral or policy choices. Most importantly, the most dangerous weakness associated with the late 1990s crisis – the vulnerability of the banking system to a run on the country's currency – has been resolved. Dollarization has eliminated the risk of holding the national currency, and therefore has most likely made crises of the type that the country experienced in the late 1990s a thing of the past.

Dollarization and Recovery

Ecuador adopted the dollar as its national currency in 2000. There are advantages and disadvantages, including risks, for a country giving up its national currency for the dollar. The main advantage is the relative stability of the dollar. Ecuador had high inflation prior to dollarization, averaging more than 40 percent over the years 1983-1999. Perhaps equally important, the country had a high level of *de facto* dollarization: by 1999 this had reached about 45 percent of country deposits and two-thirds of all (including off-shore) deposits.[14] This level of de facto dollarization makes the financial system particularly vulnerable to crises. Businesses whose revenue is in *sucres* but payments are in dollars, for

[11] Stanley Fischer, "Ecuador and the IMF," May 2000.
[12] Banco Central de Ecuador.
[13] Jacome, Luis I. "The Late 1990s Financial Crisis in Ecuador: Institutional Weaknesses, Fiscal Rigidities, and Financial Dollarization at Work," International Monetary Fund, January 2004: http://www.imf.org/external/pubs/ft/wp/2004/wp0412.pdf, p. 5.
[14] "Ecuador: Selected Issues," International Monetary Fund, March 2006: http://www.imf.org/external/pubs/ft/scr/2006/cr06103.pdf; and Jacome, January 2004.

FIGURE 2
Ecuador: Public Sector Current Expenditure (Percent of GDP)



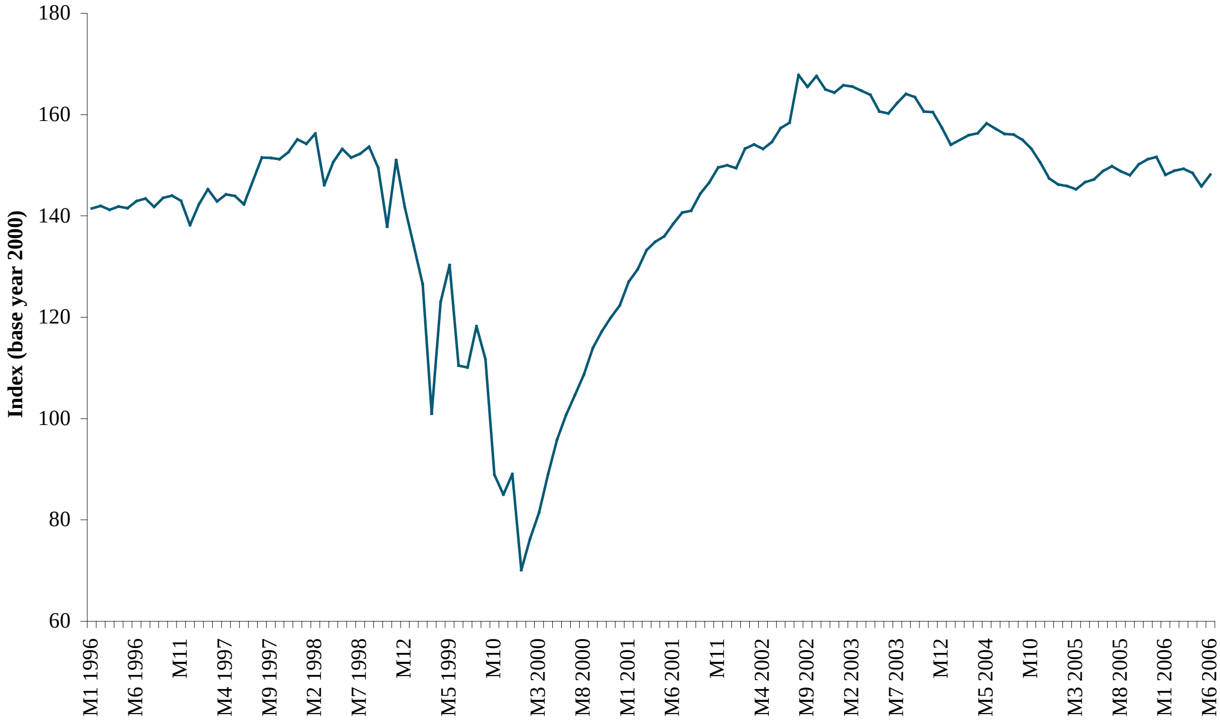
Source: Central Bank of Ecuador

example, can get hit hard when the currency drops; and the fear of further declines in the domestic currency can lead to a flight to dollars and instability in the banking system. These problems were a big part of the 1999 crisis.

Dollarization gets rid of these risks, and this has been an important success of that policy. It had also helped enormously to bring down inflation from 96 percent in 2000 to 3.3 percent today. On the other side of the equation, one of the disadvantages of dollarization is that the country loses control over monetary and exchange rate policy, and therefore does not have these instruments available to adjust to external shocks or imbalances. If the country runs a trade deficit, for example, the exchange rate cannot adjust in order to bring this into balance. If there is a fall in oil prices or other external shocks, the government cannot use monetary policy or exchange rate policy to help stimulate the economy. If the dollar is overvalued, Ecuador's exports and import-competing industries would suffer. And adopting a foreign currency also severely limits the Central Bank's capacity for acting as a lender of last resort for the financial system.

Despite these potential risks and disadvantages, dollarization appears to have worked pretty well for Ecuador so far. The main potential weakness has been a possible overvaluation of the country's exchange rate, since the dollar is generally overvalued and the government cannot affect its exchange rate. Figure 3 shows Ecuador's real effective exchange rate, against a trade-weighted basket of

FIGURE 3
Ecuador: Real Effective Exchange Rate (Index)



Source: IMF, International Financial Statistics

currencies. As can be seen, it increased by 139 percent after the dollar was adopted in 2000; it has since retreated by only 11 percent.

Ecuador's trade balance can be seen in Table 2. There was a large trade surplus in 2000 (9.2 percent of GDP), but this was mainly due to a surge in oil revenue. The trade surplus reverted to deficit in the succeeding years and then to surpluses for 2004-2006; but again this is overwhelmingly due to the behavior of oil revenues, which account for about 75 percent of export earnings.

If we look at non-oil exports, which are more likely to be affected by the country's exchange rate, there is a large drop from 17.8 percent of GDP in 1999 (the last year before dollarization) to 10.6 percent for 2006. This decline was confined to the traditional export sector; non-traditional exports (including flowers and canned fish, the two largest non-traditional exports) have actually increased over the period. The traditional sector, including bananas, was hard hit by the effects of El Nino; and shrimp exports suffered from an outbreak of white spot disease in 1998-2000 from which they have yet to recover, remaining at 5 percent of total exports today as compared to 14 percent in 1999.

So the effects of dollarization on Ecuador's exports are not easy to gauge. Since the dollar is generally overvalued internationally, and given the huge rise in the country's real effective exchange rate since dollarization, it is very likely that dollarization has lowered Ecuador's export earnings, economic growth, and potential GDP relative to what these would be with a national currency that

TABLE 2
Ecuador: Main Economic Indicators, 1997-2005

	1997	1998	1999	2000	2001	2002	2003	2004	2005
					annual % change				
Real GDP, total	4.1	2.1	-6.3	2.8	5.3	4.2	3.6	7.9	4.7
Oil sector	-2.1	-1.9	-8.9	0.9	1.1	-4.4	6.7	35.4	-3.4
Non-oil sector	5.1	2.8	-6.1	3.1	5.5	3.9	3.5	3.6	5.8
Real GDP per capita	2.0	0.1	-8.1	0.9	9.6	0.1	2.1	6.4	3.3
GDP expenditure-based									
Consumption	4.3	3.6	-6.8	3.9	5.8	6.3	4.7	4.5	6.1
General government	4.7	-2.2	-5.5	4.7	-0.6	4.3	1.4	3.6	3.4
Households	4.2	4.5	-7.0	3.8	6.8	6.6	5.2	4.6	6.4
Investment (Gross capital formation)	12.5	14.2	-49.4	29.0	45.0	21.6	-14.8	12.0	10.0
Exports of goods and services	7.8	-5.1	7.8	-1.0	-0.8	-0.8	9.6	15.8	7.4
Imports of goods and services	15.4	7.0	-29.5	15.8	24.8	16.7	-3.9	11.1	13.5
External Sector									
					% of GDP				
Current account balance	-1.8	-8.6	5.3	5.8	-2.9	-5.1	-1.5	-1.7	-0.2
Trade Balance	2.5	-4.3	10.0	9.2	-1.4	-3.9	-0.1	0.5	1.5
Exports, FOB	22.3	18.1	26.7	30.9	22.0	20.2	21.7	23.8	27.7
Oil	6.6	4.0	8.9	15.3	8.9	8.3	9.1	13.0	16.1
Non-oil	15.7	14.1	17.8	15.6	13.1	12.0	12.6	10.8	11.6
Imports, FOB	19.7	22.4	16.7	21.8	23.4	24.1	21.8	23.2	26.2
Oil	1.6	1.2	1.2	1.6	1.2	0.9	2.6	3.0	4.7
Non-oil	18.1	21.2	15.5	20.2	22.3	23.2	19.3	20.2	21.5
Total External Debt	63.5	69.8	95.4	82.9	67.7	65.2	58.5	52.7	47.2
Public	52.9	56.2	80.2	69.0	53.4	45.5	40.1	33.9	29.7
Private	10.7	13.6	15.2	14.0	14.3	19.7	18.4	18.8	17.5

(continued)

TABLE 2 (continued)
Ecuador: Main Economic Indicators, 1997-2005

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Fiscal Sector (1)									
					% of GDP				
Total revenue	19.9	17.3	21.1	25.9	23.3	25.5	24.1	25.1	25.1
Oil	5.4	3.9	6.3	9.2	6.4	5.6	5.8	6.5	6.1
Non-oil (2)	14.6	13.4	14.8	16.7	17.0	20.0	18.3	18.6	
Total expenditure	22.1	22.1	25.0	24.4	23.3	24.7	23.0	23.0	24.3
Current	16.8	17.2	19.0	19.4	16.7	18.4	17.9	18.0	19.3
Interest	4.2	4.2	7.1	6.6	4.7	3.4	2.9	2.4	2.2
External	3.2	3.2	5.0	5.4	3.7	2.7	2.2	1.9	1.8
Domestic	1.0	1.0	2.1	1.2	1.0	0.7	0.6	0.5	0.4
Capital	5.3	5.0	6.0	5.0	6.6	6.4	5.1	4.9	5.0
Overall balance	-2.1	-4.8	-3.9	1.5	0.0	0.8	1.6	2.1	0.7
Primary balance	2.1	-0.6	3.2	8.1	4.7	4.2	4.4	4.5	2.9
Non-oil balance	-7.5	-8.7	-10.2	-7.7	-6.3	-4.8	-4.2	-4.4	-5.3
Total Public Debt	59.9	66.6	98.3	86.7	66.5	56.7	50.6	44.6	39.8
External	52.9	56.2	80.2	69.0	53.4	45.5	40.1	33.9	29.7
Domestic	7.0	10.5	18.1	17.8	13.2	11.1	10.5	10.7	10.1
Additional Items									
GDP, current (in billions of US$)	23.6	23.3	16.7	15.9	21.2	24.9	28.6	32.6	36.5
GDP per capita (in current US$)	1,980.1	1,910.1	1,343.5	1,260.0	1,748.0	1,966.7	2,229.8	2,505.3	2,761.2
GDP per capita PPP (in current US$)	3,381.9	3,423.6	3,192.3	3,291.0	3,684.4	3,720.3	3,844.4	4,158.0	4,316.2
Investment, % of GDP (gross capital formation)	21.5	25.3	14.7	20.1	24.3	26.5	21.5	23.4	24.3
Inflation, average (annual % change)	30.6	36.1	52.2	96.1	37.7	12.6	7.9	2.7	2.1
Population (in millions)	11.9	12.2	12.4	12.6	12.2	12.7	12.8	13.0	13.2

Sources: Banco Central del Ecuador (BCE); International Monetary Fund (IMF), World Economic Outlook (WEO), September 2006

Notes: (1) refers to the non-financial public sector (NFPS)

(2) Includes taxes, contributions to social security, revenue generated by state enterprises and other sources

was stable and more competitive. On the other hand, the government was not able to maintain a stable exchange rate prior to dollarization, and the effects of this instability on the macroeconomy were not manageable. On the positive side looking forward, it is likely that the dollar will depreciate in the future, since the United States cannot continue running current account deficits of more than 6.6 percent of GDP indefinitely.[15]

Neither candidate in the run-off election has suggested reversing the country's adoption of the dollar as its national currency.

With regard to other macroeconomic conditions, the next president will inherit an economy that has improved steadily since 2000, and is more stable than it has been in decades. According to Central Bank data for the first half of 2006, there is a trade surplus of 1.4 percent of GDP, and a current account balance of 1.1 percent. The central government budget is also running surplus of 1.7 percent of GDP. Consumer price inflation is at an extraordinarily low 3.3 percent annual rate. While these macroeconomic indicators are sound, perhaps the main vulnerability is that the government's fiscal balance would suffer from a significant and sustained decline in oil prices. Oil export revenue is about 7 percent of GDP; thus a 28 percent decline in oil prices, for example, would shift the fiscal balance downward by about 2 percent of GDP.

International Trade and Finance, and U.S.-Ecuador Relations

One of the significant differences between the two candidates is their positions regarding international trade and finance, and relations with the United States. Noboa is a staunch ally of the United States government, and supports its foreign and commercial policy in the region. He has promised to cut diplomatic relations with Venezuela and Cuba if he is elected, and to sign a proposed Free Trade Agreement with the United States.

By contrast, Correa has taken a more skeptical approach in these areas. He rejects the proposed Free Trade Agreement with the United States and said that he would not grant renewal for the U.S. military base at Manta when the agreement in 2009. He has also criticized the IMF and World Bank, saying that they "have not been part of the solution, but part of the problem."[16] In addition, he has talked about restructuring the country's debt in order to free up resources for increased social spending, rattling financial markets.

Looking first at the IMF and World Bank, Ecuador was under IMF agreements for most of the years between 1983-1995, adopting many of the Fund's recommended policies. But the country never recovered to even its pre-1980 level of per capita GDP.

The World Bank, IMF, and Inter-American Development Bank supported a number of structural reforms in the 1990's, including privatizations, financial liberalization, reduction of state employment, deregulation, and legal changes that were necessary in order to bring about these structural reforms.[17] There is little doubt that some of these reforms helped create the instability that

[15] See, e.g. Mark Weisbrot and David Rosnick, "A Shrinking Market: Projections for U.S. Imports," July 2006: http://www.cepr.net/index.php?option=com_content&task=view&id=65&Itemid=8.
[16] Gonzalo Solana, Associated Press, September 25, 2006.
[17] See, e.g. World Bank (1994), "Ecuador-Structural Adjustment Loan," Report No. PIC1551, Washington, DC. Available online at: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1997/09/05/000009265_3971229181720/Rendered/PDF/multi0page.pdf and Inter-American Development Bank (2003).

led to the crisis of the late 1990s. For example, capital account and financial liberalization spurred financial inflows, a credit boom, and a proliferation of dollar and offshore deposits that increased the vulnerability of the financial system.[18] Other reforms may have been helpful, but the overall result was the growth failure described above, followed by an economic collapse in 1998-2000. It is beyond the scope of this paper to evaluate the effectiveness of these institutions' macroeconomic and structural reform policies in Ecuador, but it is difficult to see how they could be found to be successful before 2000.

Ecuador reached a new agreement with both the IMF and the World Bank in 2000, and economic growth has been much better since then, as noted above. However, there was a serious dispute with the World Bank as to the use of oil export revenues since oil prices have risen. The Fiscal Responsibility and Transparency Law of 2002, which these institutions supported, created an Oil Stabilization Fund (FEIREP). Under this law, the Stabilization Fund, which was created with and received oil export revenues, was required to spend 70 percent of its revenues on purchasing (i.e. paying off) debt, and 10 percent for social spending. The law also limited the growth in real primary expenditures to 3.5 percent annually.

After President Lucio Gutierrez was removed from office (April 2005) – partly as a result of protests against these and other economic policies that generated popular discontent – the Congress in June 2005 approved changes that allowed for 30 percent to be spent on education and health, 10 percent on research and development, and some of the remainder on investment. The ceiling on primary expenditures was removed for infrastructure spending and raised to 5 percent for other capital spending.

As a result of these changes, the World Bank suspended a $100 million loan to Ecuador in August 2005.[19] The government then followed up on an arrangement for a $500 million bond issue, $300 million of which was to come from the government of Venezuela.

The end result was Ecuador's first voluntary bond placement on the international markets since 1997, at $650 million; only $25 million was borrowed from Venezuela. However, the risk premium (due to previous defaults) was very high, and remains today at 5.4 percentage points above U.S. Treasury yields, as opposed to 2.31 for Venezuela and 3.06 for Argentina, which had the largest sovereign debt default ever in 2002. Ecuador barely has access to international credit markets at present.

Table 2 shows the evolution of Ecuador's public debt, both internal and external. As can be seen, as a result of the 1999 default and restructuring, and even more due to the growth of the economy and the use of government revenues (including oil export revenues) to pay off debt, the country's public debt fell from a high of 94.5 percent of GDP in 1999 to 34 percent this year. However, debt service payments are still significant: interest payments are $824 million (2005), 2.2 percent of GDP, or 11.4 percent of government expenditure. In addition, the government paid about 4.5 percent of GDP ($1.8) in amortization for 2005.

"Financial Market Development. Support from the Inter-American Development Bank Group 1990-2002," Washington, DC (http://seip.guanajuato.gob.mx/index.php?option=com_docman&task=doc_view&gid=93); and 2005 (http://seip.guanajuato.gob.mx/index.php?option=com_docman&task=doc_view&gid=93).

[18] See e.g. Nazmi, Nader, "Failed Reforms and Financial Collapse in Ecuador,"Quarterly Review of Economics and Finance 41 (2001), 727-735.

[19] Rafeal Correa was Finance Minister at the time and resigned later that month.

Correa has said that he might want to restructure the debt in order to free up resources for social spending and public investment. Clearly this would upset the financial markets and lower Ecuador's bond credit rating. Against this risk must be weighed: (1) that Ecuador is effectively excluded from international credit markets in any case; (2) the potential economic growth, poverty alleviation, and investment in human capital that might result from these increased resources. Since Ecuador has $14 billion of debt and not much to lose in terms of creditworthiness, the government would appear to be in a good bargaining position for any restructuring. Furthermore, a restructuring of international debt would not be likely to cause a financial crisis in the domestic economy, since the economy is dollarized and there would be no reason for domestic depositors to panic in the event of such a restructuring

The government's bargaining over a restructuring would be strengthened by the fact that it would almost certainly have access to credit from the government of Venezuela, which offered to loan $300 million to Ecuador in 2005 and has loaned $2.5 billion to Argentina and hundreds of millions of dollars to Bolivia. Given Ecuador's lack of access to international credit markets, Venezuela is probably a likely source of credit in the near future in any case. And the government is not in immediate need of international credit, as Ecuador is presently running a trade surplus. So although Correa's statements about possible restructuring have been met with criticism in the financial press, if he were to undertake negotiations for a restructuring, the government would have a very strong negotiating position, and the restructuring would not necessarily lead to financial instability within the country.

Trade is another issue where the candidates differ, with Noboa supporting a proposed Free Trade Agreement with the United States and Correa opposed. The question may be moot, as the prospects for such an agreement look rather slim regardless of who is elected. Protests against the proposed agreement, led by indigenous groups, shut down much of the country last March. The protesters were opposed to increased access for U.S. agricultural products, including subsidized crops such as rice and corn, on Ecuadorean farmers. There were also concerns about proposed tightening of intellectual property restrictions relating to patented medicines, beyond what is currently agreed upon in the WTO's TRIPS (Trade Related Aspects of Intellectual Property Rights), which would increase the price of medicines.

On the other side of the equation, it is not clear what Ecuador would gain from an FTA with the United States, since it already has preferential access to U.S. markets through the ATPDEA (The Andean Trade Preferences and Drug Eradication Act) and its predecessor, the Andean Trade Preferences Act (ATPA).

Table 3 shows U.S. imports from Ecuador since 1997. It is worth noting that three-quarters of these imports are oil; Ecuador is the 11th largest supplier of oil to the U.S. market. Of the remaining 25.1 percent of imports that are not oil, 21.6 percent enters the U.S. market with preferential treatment from either ATPA or ATPDEA.

The main advantage of an FTA would therefore be that these preferences would not have to be renewed. However, the near future of the ATPDEA now looks secure.

TABLE 3
US Imports from Ecuador by Program (1997-2006)

		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
						(US$ millions)					
Total	ATPA	217.4	233.0	260.3	247.6	216.3	85.7	241.0	1,086.6	1,246.2	769.9
	ATPDEA	0.0	0.0	0.0	0.0	0.0	84.1	1,329.2	2,386.5	3,549.5	2,270.3
	Others	1,838.0	1,522.2	1,554.0	1,962.9	1,825.7	1,976.0	1,150.7	811.6	962.9	740.0
	Total	2,055.4	1,755.2	1,814.3	2,210.5	2,042.0	2,145.8	2,720.9	4,284.7	5,758.7	3,780.2
Oil	ATPA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	814.9	969.6	585.9
	ATPDEA	0.0	0.0	0.0	0.0	0.0	84.0	1,288.9	1,520.4	2,511.5	1,638.8
	Others	659.9	399.6	530.0	1,220.7	971.1	956.9	177.8	671.8	882.4	606.0
	Total	659.9	399.6	530.0	1,220.7	971.1	1,041.0	1,466.7	3,007.0	4,363.5	2,830.7
Non-Oil	ATPA	217.4	233.0	260.3	247.6	216.3	85.7	241.0	271.8	276.7	184.1
	ATPDEA	0.0	0.0	0.0	0.0	0.0	0.1	40.3	866.1	1,038.0	631.4
	Others	1,178.1	1,122.5	1,024.0	742.2	854.6	1,019.1	972.8	139.8	80.5	134.0
	Total	1,395.5	1,355.5	1,284.3	989.8	1,070.9	1,104.9	1,254.2	1,277.6	1,395.2	949.5
		1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
						(% of total Imports)					
Total	ATPA	10.6	13.3	14.3	11.2	10.6	4.0	8.9	25.4	21.6	20.4
	ATPDEA	0.0	0.0	0.0	0.0	0.0	3.9	48.9	55.7	61.6	60.1
	Others	89.4	86.7	85.7	88.8	89.4	92.1	42.3	18.9	16.7	19.6
	Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Oil	ATPA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	19.0	16.8	15.5
	ATPDEA	0.0	0.0	0.0	0.0	0.0	3.9	47.4	35.5	43.6	43.4
	Others	32.1	22.8	29.2	55.2	47.6	44.6	6.5	15.7	15.3	16.0
	Total	32.1	22.8	29.2	55.2	47.6	48.5	53.9	70.2	75.8	74.9
Non-Oil	ATPA	10.6	13.3	14.3	11.2	10.6	4.0	8.9	6.3	4.8	4.9
	ATPDEA	0.0	0.0	0.0	0.0	0.0	0.0	1.5	20.2	18.0	16.7
	Others	57.3	64.0	56.4	33.6	41.9	47.5	35.8	3.3	1.4	3.5
	Total	67.9	77.2	70.8	44.8	52.4	51.5	46.1	29.8	24.2	25.1

Source: U.S. International Trade Commission
Note: 2006 data is for the period between January and August

A few months ago, the ATPDEA, set to expire at the end of this year, could possibly have expired. Key Republicans such as Charles Grassley, chair of the Senate Finance Committee, were opposed to extending the preferences for Bolivia and Ecuador. Their strategy was to pressure these countries to agree to an FTA as the only way of maintaining their trade preferences, and possibly to influence the outcome of Ecuador's presidential election. But on November 14 the White House urged Congress to pass the extension of the ATPDEA for all four of the countries (Bolivia, Colombia, Ecuador, and Peru). And the election of a Democratic Congress on November 7 eliminates the ability of Grassley or other Republican lawmakers block the extension. At the same time it makes an FTA with Ecuador much less likely, even in the unlikely event that Ecuador were to reach an agreement with the Bush Administration.

Finally, it is worth looking at whether U.S.-Ecuadorian relations, and therefore commercial relations would differ depending on who is elected – since Noboa has closely allied himself to U.S. policy in the region, and Correa has not. As explained above, trade preferences are no longer contingent on the outcome of this election, if indeed they were prior to November 7. More importantly, the general trend in recent years has been for the United States to maintain continuity of commercial and even aid relations with left-of-center governments in Latin America.[20] This was seen in the case of Bolivia, where indigenous leader Evo Morales, who the Bush Administration clearly did not want to be president, was elected in December. So far, there has been no reduction in aid disbursements or commercial relations with the new government, despite some occasional unfriendly comments from both sides.

Even more striking, various U.S. officials used almost unprecedented economic threats in attempt to influence the recent Nicaraguan election of November 5. Republican Congressman Dana Rohrabacher warned of another economic embargo and the cutoff of vital remittances that Nicaraguans in the United States send home to their families. The U.S. Ambassador to Nicaragua Paul Trivelli warned that the United States would "reevaluate relations" with Nicaragua if the former president Daniel Ortega were to win. U.S. officials' intervention went so far as to prompt a public rebuke from the Organization of American States, who asked them to stay out of the election. But Daniel Ortega did win, and so far none of the pre-election threats appear imminent. Since U.S. officials have remained silent regarding the Ecuadorian election, there is no reason to think that commercial or financial relations with the United States would vary with the outcome.

[20] For more on the economic and political changes that have brought about this new relationship between the United States and Latin America, see Weisbrot, Mark: "The End of An Era" http://www.cepr.net/index.php?option=com_content&task=view&id=373.

Appendix

TABLE 4
Ecuador: Quarterly Economic Indicators, 2004-2006

	2004				2005				2006	
	I	II	III	IV	I	II	III	IV	I	II
					year-over-year % change					
Real GDP	7.5	12.0	7.6	4.9	4.6	4.7	4.4	5.3	5.6	…
Oil GDP	42.3	82.1	29.8	6.7	2.2	-6.0	-10.5	1.0	1.8	…
Non-oil GDP	3.0	4.7	3.7	3.1	4.4	5.9	6.5	6.3	6.0	…
					millions of US$					
Exports, FOB	1,690.6	1,987.8	2,037.7	2,036.9	2,221.7	2,473.5	2,684.8	2,720.0	3,000.4	3,228.6
Imports, CIF	1,665.4	1,913.3	2,047.9	2,245.9	2,353.8	2,532.4	2,513.3	2,887.4	2,786.3	2,915.3
International Reserves	823.7	884.7	1,179.7	1,069.6	1,025.4	1,217.0	1,568.0	1,714.2	1,859.1	1,745.9
Real effective exchange rate, consumer prices (average index, 2000=100)	155.0	157.3	155.7	150.4	145.8	147.6	148.9	151.0	148.8	147.5
Unemployment, total (%)	11.2	11.4	10.7	10.7	11.5	10.7	11.0	9.6	10.4	10.2
Open unemployment (%)	7.9	8.3	6.9	6.9	8.2	7.4	6.9	5.2	5.7	5.3
Employment (% employed / EAP)	88.8	88.6	89.3	89.3	88.5	89.3	89.0	90.4	89.6	89.8
Consumer prices (average, year-over-year)	3.9	3.2	2.0	1.9	1.7	1.8	2.2	2.9	3.8	3.3
Lending Rates (annualized percentages)	11.7	9.5	8.8	8.7	8.8	9.0	9.5	10.0	9.4	9.4

Sources: Banco Central del Ecuador (BCE)