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"Who's Driving?"

Peter Bird Martin
Exeuctive Director
Institute of Current World Affairs
Wheelock House
4 West Wheelock Street
Hanover, NH 03755

Dear Peter,

The average businessman, arriving in Ecuador from Bolivia and Peru, is likely to notice a few differences. Most immediately, Ecuador's well-maintained road system permits easy transit and frequent commerce between the sierra and the coast, thus easing somewhat the historical conflict -- rooted in a lack of infrastructure -- that has plagued high and lowlanders in the Andes since the Spanish Conquest. The fact that 500 kilometers of paved roads have been steam-rollered into 4,000 kilometers of asphalted highways in the last 20 years is all the more impressive given the respective underdevelopment and decay of the transport sector evident in Ecuador's neighbors to the south.

One only need bear in mind that Bolivia can boast but two decent "carreteras". One road begins at the Lake Titicaca frontier with Peru and ends in the mining center of Oruro. Another stretches out from the Cochabamba valley to the eastern lowlands of Santa Cruz. By contrast, the main road utilized for trade (and contraband) with Chile is little more than a sand track on the Bolivian side of the border.

Peru's own efforts to build a viable transportation network in the 1960's have been negated by nearly a decade of terrorist violence and economic mismanagement in the 1980's. Bridges along the "Carretera Central" are a favorite target of Sendero Luminoso. And willful policies that have led to an estimated 1989 annual inflation rate of 2,000% under Alan García's government stretch public resources to the limit. Still to be repaired are large sections of the Pan-American Highway damaged when the Pacific Ocean's Niño Current shifted in 1983, causing floods in the northern coastal desert and taking parts of the road back to sea when the torment subsided.

If Ecuador's relative prosperity stands out, then so too does the reason. This is the story of petroleum.

But this tale of distinct economies is also a variation on the same old theme. Stopped recently in Quito for driving through what she maintains was a yellow traffic light, ~~a~~ middle-class Ecuador youth protests, "It was

William L. Melvin is a Fellow of the Institute studying South American Indian societies and Andean affairs.

simply an excuse for the policeman to nab a bribe. It used to be that if you really committed an infraction, you had to be careful about suggesting a payoff. The police preferred to lock you up. That is when they were making good money. Now you do not even get the chance to offer a bribe. It's expected -- and demanded."

The same young woman threw a fistful of crumpled and worn bills totaling less than S/. 500 sucres (S/. 565 = US $1) out the window at the policeman, who, in one deft move, caught the cash and handed back the youth's license. "If he had stopped to count the money, I would still be arguing," joked the lucky driver.

With official corruption running at less than US $1, the explanation is not too difficult either. That story is the story of inflation.

Since current Ecuadoran President Rodrigo Borja and his Izquierda Democratica (Democratic Left) coalition government won the national mandate from voters in the August 1988 elections, petroleum and inflation have been the two topics certain to cause a stir in polite conversation here. Now that Borja has completed his first year in office, Ecuadorans are taking the opportunity to size up his administration's record. The appraisals are mixed, and stem from a populace that is realizing that the high life Ecuador enjoyed in the 1970's -- when oil prices were on the producers' side -- is waning. Free spending, fueled by oil revenues, has been replaced by the headaches that go with servicing a foreign-debt obligation that topped US $9 billion last year. And at a time when world oil prices have fallen from a high of US $35.21 for Ecuador's Oriental Crude in 1980 to just US $12.80 in 1988, consumers in this Andean country have had to put up with prices that lept at a rate of 99.9% in 1988 before coming back down to an annual projected rate of 78.6% this year.

Ecuadorans are unaccustomed to inflation without growth. When Ecuador began to ship out petroleum and joined the Organization of Petroleum Exporting Countries (OPEC) in 1972, inflation was a mere 7.7% (annually). OPEC membership and high export volumes of crude that fetched good prices in the 1970's meant average annual GDP growth of 9.3% in that decade. When Ecuadorans compare those figures with GDP annual growth rates that averaged only 2.2% from 1980-85, and then consider the negative slide of 5.3% registered in 1987, pessimism resounds. 1988 provided reason for hope, since repairs restored the TransEcuadoran pipeline to operation (damaged in a 1987 earthquake), and crude oil production shot to its highest ever at 110 million barrels. But the 8% rise in GDP from 1987 is misleading; GDP in current dollars was still US $771 million behind the GDP revenues of US $10.96 billion garnered in 1986.

Worse still for Ecuadorans, this year real wages stood at less than ¼ of their value at the beginning of this decade. In 1981, before the sucre began its devaluation spiral, the sucre was valued at S/. 25 = US $1, and the minimum monthly wage was set at US $140. In 1989, the highest paid worker on the minimum wage scale earns but S/. 30,000. After accounting for the sucre's ill health in the intervening years, the above worker takes home just US $53 a month. And those dollars buy less in these days of inflation. Woe be it to think of the domestic maids, who are now paid a meager monthly salary of S/. 14,000.

With the collapse of the international coffee agreement -- and the subsequent depression of world prices -- agricultural export revenues have fallen and petroleum remains Ecuador's most important export. Reserves total 1.8 billion barrels, including both proven and estimated finds.

Private-sector executives and the Borja government disagree as to how long those reserves will last, but it is generally thought that this Andean nation will be hard-pressed to export significant amounts of crude oil after the year 2000. This assumes that the 1988 domestic consumption of 31.5 million barrels will remain at least static (if not grow). And Ecuador's current crude production of 105 million barrels-per-year will taper off inevitably. Production is geared to an OPEC-imposed export quotas and limited by the fact that the current TransEcuador pipeline has a daily capacity of just 305,000 barrels. One industry analyst characterized the reserve issue this way, "At this point, I would call it a political question. If the government wants to encourage exploration with more risk contracts awarded to foreign firms, they might find another 400-500 million barrels out there."

Private and public-sector officials being at loggerheads over the issue of petroleum production is nothing new in Ecuador. When a radical faction of the Ecuadoran Armed Forces set up a ruling triumvirate led by General Rodriguez Lara in 1972, one of the junta's first moves was to create the Ecuadoran State Petroleum Corporation (CEPE). The parastatal petroleum company was authorized to take over 80% of the area then contracted to foreign, private oil firms. The Texaco-Gulf consortium, which had discovered the huge Shushufindi jungle deposits in 1969, was allowed to stay. But Texaco-Gulf did not stay without bowing to General Rodriguez's demand that the consortium sell a 25% stake in its operations to the Ecuadoran government.

Further incursions by the Ecuadoran government into what had been formerly an exclusive private-sector affair followed, and most foreign firms pulled out. Nationalist politicians were outraged at the news that Texaco accounted for 95% of all Ecuadoran crude production in 1974. So, by 1977, the government had adquired all of the Gulf shares in the Texaco consortium, thus assuming majority (62.5%) ownership of the private company. In 1986, Texaco turned over to Ecuador ownership of the same TransEcuadoran pipeline the firm had built 14 years before.

The increased role for CEPE in oil production might have been a boon without qualification. Unfortunately, Ecuador's military governments in the 1970's used CEPE-generated revenues to finance public construction, development programs, and arms purchases without regard for the balance sheet of CEPE. And the oil bonanza sent bureaucrats scurrying to borrow heavily abroad. Ecuador's private-business community was no less avaricious in its consumption of foreign capital. Quiteños watched as the red-tiled roofs in the colonial center were overshadowed by mirror-windowed skyscrapers, reflecting what one Ecuadoran author termed, the "cultura petrolerista". Now that the demand for crude is down, Ecuadorans are paying the bill. The table below illustrates the close relationship between recent debt service for the foreign loans contracted in the 1970's with the revenues earned from oil exports in the 1980's:

<u>SQUEEZING THE WELL DRY</u> (in millions of US $)

	<u>Debt service</u>	<u>Oil revenues</u>
1980	1,419.1	1,393.9
1981	2,138.7	1,560.8
1982	2,632.3	1,388.3
1983	2,934.4	1,639.2
1984	1,931.0	1,678.9

SOURCE: Instituto Latino-Americano de Investigaciones Sociales, <u>Ecuador: petróleo y crisis economica</u>, Quito, 1986.

Ecuador's economy is also influenced by regional trends. The Ecuadoran economist and ex-director of the Central Bank here, Carlos Julio Emmanuel, warned his fellow colleagues this week that President Borja's relative success in stabilizing the sucre/dollar exchange rate in 1988 may have more to do with the unregulated flow of "narco" dollars from Colombia into Ecuador, thus freeing up the currency markets. And foreign diplomats are quick to point out the increased evidence of Colombian investment in Ecuadoran real estate -- opinions backed up by pointing fingers when native campesinos show interested visitors the gates to newly acquired properties in the countryside.

To the south, poor Ecuadorans make plenty of money plying the contraband trade to take advantage of the scarcity of gasoline in Peru caused by government controls there. Private analysts estimate that 10-15% of the 25.2 million barrels of gasoline and diesel fuel refined in Ecuador is slipped illegally across the border, keeping busy 2-3,000 Ecuadorans in the frontier crossing of Huaquillas. One U.S. diplomat estimates the contraband at closer to 50% of refined production,-but whoever is right, the contraband is a symptom of a greater crisis that is crossing the Andes. One Ecuadoran economist put it like this, "When you look at the problem in a practical way, the contraband is not so bad. If the Ecuadoran economy cannot create jobs for those people, and the Peruvian economy can, then I won't complain."

All the same, one cannot escape the feeling that Ecuadoran policy-makers would like to assert control over an economy yet to go completely awry. Energy Minister Diego Tamariz announced earlier this year that CEPE will be reorganized to take over all of the remaining Texaco operations in Ecuador by July, 1990. Texaco will relinquish daily management of the pipeline operation as early as 1 October 1989 to a new CEPE -- named PETROECUADOR -- that will be designed to function as a holding company. Independent branches of the state company will be responsible for oil exploration, production, commercialization, and transport. However, the new monopoly (which also takes over Texaco's concessions in the jungle) will be governed by a board of directors that hardly resembles that of most private firms. Board members will include the Ministers of Energy, Finance, and Industry; two delegates, to be named by the country's president and vice-president; the director of the Central Bank; and the Commander-in-Chief of the Ecuadoran Armed Forces. Pardon those impertinent businessmen who might have demanded a petroleum geologist on the board.

Then too, given CEPE's past role in subsidizing other sectors of the Ecuadoran economy, sceptics abound to wonder how the new PETROECUADOR will finance its future operations. Besides swallowing Texaco, PETROECUADOR managers will have to digest a CEPE deficit that ran to S/. 2.9 billion in internal obligations and US $229 million in foreign debt paper as of 1986, the last year public figures were available. That deficit has no doubt grown since 1986. Even so, the legislative plan creating PETROECUADOR envisages that 10% of all revenues generated by the company will go to investment (of that, 40% will be marked for exploration). The remaining 90% will go to government coffers. Said a senior Texaco executive, "I wish them luck. But it looks like they are trading Texaco for the World Bank. Only time will tell if that is a wise move."

As ever,

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