



 KCS Country Risk & Threat Advisory

KCS Group Europe
Risk & Threat Advisory Paper

Political Risk Advisory Briefing: Ecuador
February 2019

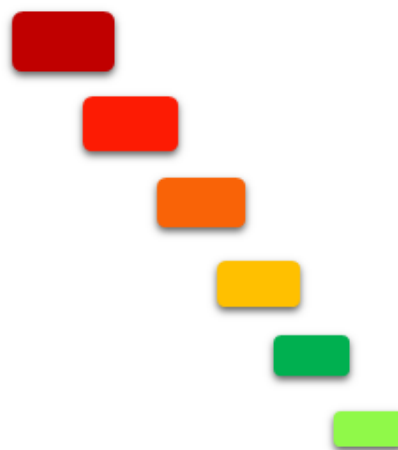
Political Risk Advisory Briefing: Ecuador



Country: Ecuador
Population: 16,987,883
Source: United Nations

Ecuador has a risk rating of 4.25

- 6 Very High** The assorted threats described in the report are almost certain to have a derogatory effect.
- 5 High** The threats are extremely likely to negatively affect the business.
- 4 Very Possible** There is a strong likelihood of problems arising in this country.
- 3 Possible** There is a fair chance of problems arising in this country.
- 2 Low** There is a low likelihood of any threats impacting business.
- 1 Very Low** There are virtually no impediments to successful business in this country.



Overview

As Brazil faces an uncertain future with the Trump of the Topics, Argentina is mired in recession and financial downfall, and Venezuela continues to collapse in every social, economic and political metric that man has invented, Ecuador is treading a new and somewhat unique path.

Serious economic and social change is afoot, creating new challenges, opportunities and risks. A country that has, in the past, tended to pass comparatively under the radar, unlike its Latin cousins, Ecuador now seems to be maturing out of the “Pink Tide” of socialism that swept through the continent at the turn of the millennium, whilst others in South America double down.

Evidently, the path will not be smooth sailing. A re-evaluation of old friendships, and rivalries, means that Ecuador is in a state of political and economic evolution. This change of course has made President Lenin Moreno many enemies. The audacity of his policies means that he could well be a one-term President, jeopardising reform in its entirety.

Other problems on the horizon should be of serious concern. Staggering levels of debt and loans structured in a way that gives China access to almost all of Ecuador’s oil for low prices means that, in some ways, China has Ecuador in its pocket. There is also a threat from FARC dissidents who have refused to lay down arms in Colombia and have subsequently crossed the border into Ecuador.

And yet, it is an exciting time to be doing business in Ecuador. New resource and energy concessions are of real interest and reward to foreign companies as Moreno opens the country up to private foreign investment. Companies must, however, move quickly and be aware of the pitfalls and risks associated with Ecuador.

Politics

The previous government under the presidency of Rafael Correa (2007 – 2017), founder and leader of the Alianza PAIS party, was not an unqualified success. High levels of government spending, severe economic slowdown and a collapse in petroleum prices led to foreign investment in Ecuador plummeting with knock-on effects being felt domestically. Mass protests ensued in 2015, with hundreds of thousands of Ecuadorians marching in the streets.

By the end of Correa's tenure, reliance on oil, public overspending, and devastating earthquakes in 2016 (resulting in more than 650 deaths and damage equivalent to 3% of GDP) caused Ecuador's economy to enter a recession, resulting in heavy government spending cuts.

There is a sense that under President Moreno (also of the Alianza PAIS and Correa’s former Vice President), Ecuador is moving slowly towards progress that had either stalled or was never on the cards, under Correa. A facet of this is a recalibration of the Ecuadorian economy and its geopolitical relations, both in South America and farther afield.

Most importantly, he has made a point of improving relations with the United States, buying weapons, radar sets, helicopters and other military equipment. The deal will also include intelligence sharing between the two countries.

Economically, Moreno has shifted Ecuador away from the leftist clique of South American nations, although he is certainly no Bolsonaro. In August 2018, Ecuador withdrew from the Bolivarian Alliance for the Peoples of Our America (ALBA), a regional bloc founded by Cuba and Venezuela, in a bid to further distance itself from outright socialism and the economic stagnation of both countries.

Moreno stated that the organization "has not worked for a while", whilst the Foreign Minister said that Ecuador wanted to be "independent of organizations that are trying to impose "specific views" on Latin America's social and political issues" - a key break with the past.

Other changes include a reform of the energy, oil and mining sectors – something attracting a great deal of interest from foreign companies. Furthermore, Moreno claimed privatisation of Ecuador's many bloated state-owned enterprises would commence immediately. Others would be liquidated, along with swathes of public sector jobs and entire ministries, effectively dissolving Correa's hostility towards private business and large foreign enterprises. Seemingly, the only ministry created in recent years was the Mining Ministry – a clear and assuring sign to foreign corporations.

He has also barred Correa from office, essentially safeguarding Ecuador's future against large inefficient state control and a more potent form of socialism. In 2018, President Moreno created the Council of Citizen Participation and Social Control (CPCCS-T), essentially tasked with purging Correa's remaining influence in public bodies, including the security services, the judiciary and the National Electoral Council (CNE).

However, this shift to the centre has come at a high price, with Moreno's approval ratings dropping steadily over the past year. The division between supporters of Moreno and those that still support Correa has also damaged the Alianza PAIS to the point that Moreno may well be a single-term president.

Politically, Ecuador is at a turning point in its history. There are certainly issues that persist, most notably staggering levels of debt, press freedoms and conflict between government and indigenous groups.

However, political and economic reforms make Ecuador an increasingly attractive proposition to foreign companies, big and small, particularly in light of continental developments elsewhere.

Economy & Business Environment

Historically, Ecuador has one of the largest fiscal deficits in Latin America. Loans, and the servicing of those loans, from the 1970s onwards have caused 'incalculable damage' to Ecuadorian society and the economy.

In 2008, a full audit of all Ecuadorian loans was completed, resulting in President Correa declaring that much of the debt was illegal under international and domestic law, enabling Ecuador to write much of it off. However, in recent years hefty loans, secured with oil, have continued to pile up, both under Correa and Moreno, in order to pay for development and infrastructure projects. Moreno vowed to reduce it from a projected 5.6 per cent this year to 2.5 per cent by 2021.

Moreno has also claimed his government would not raise taxes, but would raise \$810 million over the next few years by simplifying the tax system, making it more efficient, increasing customs tariffs and renegotiating the terms of some of Ecuador's debt.

However, in late 2018 he secured more substantial loans from China (\$900 million) and international lenders (\$1.1 billion). A point for concern is Ecuador's overreliance on oil and China – 90% of Ecuador's crude is shipped direct to the People's Republic at a discount, who then sells it on for a profit, much to Ecuador's chagrin. In return for a faulty, poorly built dam, Ecuador has run up \$19-billion in debt to China, slowly bankrupting Ecuador in the process.

Ecuador has fallen hook, line and sinker for Beijing's 'debt trap'. The Chinese-built Coca Codo Sinclair has turned into a huge white elephant – economically and environmentally it is disastrous for the country, shackling it to China in perpetuity. Tellingly, almost every senior Ecuadorean official involved in the dam is either in prison or being sentenced on bribery charges.

After contracting in 2016, Ecuador's economy bounced back in 2017, expanding by a better than expected 3%. An OPEC member, the country has benefited from higher oil prices since President Moreno came to power, however, this cannot be relied upon indefinitely. The government recently presented the 2019 budget to Congress, which aims to gradually reduce the fiscal deficit, mainly thanks to higher oil revenues and by cutting public sector wages. The FT surmises that despite "Moreno's upbeat message, economists remained sceptical about Ecuador's ability to slash its fiscal deficit so quickly".

In the decade up to 2016, poverty decreased from 36.7% to 22.5%. Annual GDP per capita growth was 1.5% (as compared to 0.6% over the prior two decades). Inequalities, as measured by the Gini index, decreased from 0.55 to 0.47 over the same period. The rise of a middle class in Ecuador is a relatively recent phenomena, doubling over the course of the commodities boom (2005 to 2015) to 38% of the population. The political and economic ramifications of this are important, promoting stability and investment within the country.

Mining

Resource mining is a highly contentious issue in Ecuador. It is far from a given that a 'free pass' will be on offer for growth in this area. A recent BMI Research report states that the value of the industry is set to jump from \$1.1 billion this year to \$7.9 billion in 2021. Although the government has announced the intent to double its mining returns by 2021, local judiciaries are trying to ban concessions from being explored in their own jurisdictions.

Despite regular protests by indigenous groups a new series of mines will soon begin output. In the next five years increased production could give Ecuador the ability to produce around 120,000 tonnes of copper and 800,000 ounces of gold, 3 million ounces of silver and 20,000 tonnes of zinc annually. Almost 2 million acres of rare, protected forest are marked for mining exploration, but the political and social resolve to force this through is uncertain.

Mining companies are, however, not deterred. Ecuador has emerged as an exciting mining investment destination, predominantly thanks to a revised regulatory framework and a major investor engagement campaign that has already attracted hundreds of applications for concessions. A less crowded market invariably means more opportunities for those that remain, and given that Ecuador plans to raise \$4bn via mining contracts in the next three years, the resource basis is simply too big for the country to ignore, especially one so highly dependent on the commodity.

Future Growth

The economy is expected to lose steam in 2019 as the government slashes public spending to strengthen its fiscal account. Meanwhile, a strong inflow of oil remittances has boosted household incomes and supported solid growth in private consumption. However, private consumption will also likely lose ground as inflation picks up and credit growth weakens. While measures are underway to close the fiscal gap, the economy might be hard-pressed to achieve its own financing plan without assistance.

Meanwhile, tighter global financial conditions pose downside risks, due to the dollarized economy's heavy reliance on external financing. Focus Economics panellists project GDP growth slowing to 1.0% in 2019, which is down 0.1 percentage points from last month's forecast, before rising to 1.2% in 2020.

Corruption & Freedoms

In the *Freedom of the Press Report 2016* by Freedom House, the press in Ecuador is classified as 'not free'. The *2016 World Press Freedom Index* by Reporters Without Borders placed Ecuador in the 'noticeable problems' category for press freedom, ranking 109 out of 180 countries. However, by 2018 it had moved up to 92nd place. In contrast, Brazil is ranked 102nd, Colombia is ranked 130th and Venezuela comes in at 143rd.

Freedom House stated in 2018 that, 'while former president Rafael Correa imposed restrictions on the media and civil society, a new administration that came to power in 2017 has begun rolling back repressive Correa-era policies'.

Under Correa, the state was guilty of cracking down on political dissent, predominantly on social media and other internet activity. Individuals have been charged over making disparaging remarks about politicians online.

Upon taking power in May 2017, the Moreno administration changed course, removing the more oppressive aspects of government oversight and media regulation, as well as initiating dialogue with the opposition and the media, previously vilified by Correa. A number of political prisoners and protesters were also released.

Ecuador has been ranked as a state with high levels of corruption. It is pervasive throughout all levels of state institutions. Freedom House reports that, '*Ecuador has long been racked by corruption, and the weak judiciary and lack of investigative capacity in government oversight agencies contribute to an environment of impunity. Investigations into alleged corruption fall under the jurisdiction of the government's office of Transparency and Social Control (FTCS), created under the 2008 constitution.*

By the end of 2013, the FTCS was investigating 84 cases of corruption, ranging from irregularities in public contracting to disputes concerning fees at educational institutions. That year, the agency launched a national anticorruption plan aimed at eradicating corruption by 2017.

A March 2014 OAS report on corruption in Ecuador recommended that the Prosecutor's Office adopt measures to ensure the timely processing of corruption cases and to remove obstacles to pursuing alleged embezzlement and illicit enrichment.

Ecuador was ranked 110 out of 175 countries and territories surveyed in Transparency International's 2014 Corruption Perceptions Index."

It is noted that ex-President Correa, in November 2018, was ordered to stand trial for his alleged involvement in the failed kidnapping of an opposition leader six years previously.

In December 2017, Moreno's Vice President. Jorge Glas, was convicted and jailed for six years in relation to "illicit association" in connection with a corruption scandal involving the Brazilian construction company Odebrecht. His successor, Maria Alejandra Vicuna, was

forced to step down in December 2018 for allegedly receiving kickbacks from staff between 2011 and 2013.

In January 2019, President Moreno announced that of \$4.9bn earmarked for oil infrastructure investment, \$2.5bn USD had been lost. Moreno cited numerous projects that had gone over budget by hundreds of millions of dollars. For example, at the Esmeraldas refinery \$2.23bn USD was spent, well above the initial \$754mn USD budget. Moreno announced that, despite tripling the budget, the refinery was still offline.

Criminal Element & Terrorism

While Ecuador remains, for the most part, unaffected by domestic or international terrorism, the crime situation in the state is more serious. Armed robberies and kidnappings are on the rise in major population centres. Moreover, the entirety of the border region with Colombia is currently classified by the UK Government as unsafe to visit under any circumstances due to ongoing drug-related violence and crime in Colombia.

Violent groups from Colombia have, in the past, spilled over the border. A spate of bombings, or attempted bombings occurred in 2010/2011. Relative calm ensued until the 27th January 2018, when a bomb exploded near a police station in the town of San Lorenzo, on the Colombian border. It destroyed the station and damaged nearby buildings, leaving 28 people injured. Worryingly, FARC dissidents were likely behind the attack, despite most of the group giving up arms last year. This was the first attack of this type in the history of Ecuador.

Whilst murder rates are high, the numbers are declining year on year. As is common, Westerners will disproportionately be targets of kidnap and extortion attempts.

Foreign Affairs

President Correa was part of the 'Pink Tide', the brand of progressive economic policies and socialism that governed most of South America during the 2000s.

With Brazil's Lula da Silva, Venezuela's Hugo Chavez, Nicaragua's Daniel Ortega and Bolivia's Evo Morales, he preached a distinct social and economic path for South America. For instance, it was Correa who opened up Ecuador's London embassy as a political asylum for Julian Assange, and it is only because Alianza País is still in government that Assange has not been asked to leave, despite Moreno clearly wanting him gone. This is also a good example of the antagonistic nature of Ecuador's former relationship with the US.

Now, like Brazil, Ecuador's foreign affairs are undergoing something of a recalibration, as President Moreno breaks with the policies of Correa. Moreno is cracking down on Venezuelan influence, scrapping funding for Venezuelan news outlets like Telesur TV, for example.

Ecuador is now heavily indebted to China, owing billions of dollars for decades of loans-for-oil. This overreliance seemingly shows no sign of abating – another loan for \$900 million was agreed in December. This relationship is a point of interest, especially with Moreno's warm

overtures to the US and western companies in the last year. American Vice President Mike Pence visited Quito last year, securing trade privileges cancelled by Correa and pushing for the alienation of Venezuela.

The issues surrounding Julian Assange's ongoing stay at the Ecuadorian Embassy in London are a minor stone in the shoe of the government, but a stone nonetheless. Seemingly, Moreno would like to draw a veil over this bizarre episode, stating that Assange is free to leave as the UK has provided sufficient guarantees that he would not be extradited to the US.

Conclusion

Ecuador is certainly moving in a direction more conducive to foreign investment, opening itself up to natural resource exploration. The mining industry, in particular, has exciting potential for Western prospectors and investors. However, this development will now run concurrently with the ramifications of its dealings with China. Staggeringly high levels of debt and the loss of much of its potential oil revenue to China means that Ecuador has saddled itself with an economic ball and chain for the foreseeable future, stunting its potential for economic growth.

Although there is a long way to go, steps taken by those with power in the last few years means that Ecuador is becoming more attractive to foreign business. President Moreno has a genuine and serious mind-set when it comes to tackling the political and economic issues affecting the country. However, investors must be vigilant and go in with the knowledge that he may only be a one-term President.
