2009 Investment Climate Statement - Ecuador

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Openness to Foreign Investment

Ecuador can be a difficult place in which to do business, although it is relatively open to foreign investment. There are restrictions or limitations on private investment in many sectors that apply equally to domestic and foreign investors. As a member of the Andean Pact, Andean Decisions 291 and 292 of 1991 nominally govern Ecuador's foreign investment policy. Implementing regulations issued in January 1993 and a 1997 law to promote foreign investment sought to liberalize the investment regime. Additional legislation to facilitate private sector investment in the telecommunications and mining sectors was passed in 2000 and has led to increased foreign investment in the former, though foreign companies have been frustrated by commercial disputes. A 2006 hydrocarbons law imposed new conditions in the petroleum sector that have been problematic for many companies, complicated by a 2007 decree that imposed additional restrictions. A 2008 mining mandate stalled mining activity, and a new Mining Law is expected in early 2009. Negotiations for a free trade agreement between the United State and Ecuador, which would have included investment provisions, stopped in April 2006. The current Government of Ecuador has not expressed interest in restarting negotiations.

Inconsistent enforcement of contracts is one of the main concerns of foreign investors in Ecuador. Government officials and private Ecuadorian businesses have used regulatory schemes and questionable legal maneuvers to hinder foreign company operations in the country. Companies have sometimes been confronted with requirements of additional payments not negotiated in original agreements; receiving full and timely payments due can be another recurring problem. Business disputes with U.S. companies can become politicized, especially in sensitive areas such as the energy sector. Several commercial disputes involving U.S. companies, mostly linked to the energy sector, are currently under international arbitration.

Under current regulations, foreign investors receive the same rights of entry as Ecuadorian private investors. Foreign investment with up to 100% foreign equity is allowed without prior authorization or screening in most sectors of the Ecuadorian economy currently open to domestic private investment. Foreign investors must register their investments with the Central Bank for statistical purposes. Ecuadorian law requires private companies to distribute 15% of pre-tax profits to their employees each year. Many companies, mostly domestic, use legal loopholes to circumvent this requirement.

Prior authorization is required for license and franchise transactions. No limits exist on the amount of royalties that may be remitted. All license and franchise agreements must be registered with the Ecuadorian Intellectual Property Institute (IEPI). In September 1997, the Ecuadorian Congress repealed the law for the protection of representatives, agents and dealers of foreign enterprises, which had imposed discriminatory restrictions on foreign companies in their dealings with their Ecuadorian agents. However, dealers whose relationships predated the repeal may continue to take action under the law.

There is no legal discrimination against foreign investors at the time their investments are made. Foreign investors may participate in government-financed research programs. According to a new constitution adopted in October 2008, the Government will promote both local and foreign investment, but local investment will take priority; foreign investment should respond to national priorities as defined by the National Development Plan. The Government of Ecuador has not defined how these provisions will be implemented.

Although the scope for private sector participation has been expanded in recent years, foreign investors, and often domestic investors as well, still operate with limitations in certain sectors of the economy:

Petroleum:

All subsurface resources belong to the state. Ecuador permits investment by foreign oil companies. Foreign oil companies previously engaged in exploration and development activities were under risk-service contracts with Petroecuador. With limited exceptions, investments in the oil sector now use production-sharing contracts that give private investors the right to share in finds. However, the current Government of Ecuador has recently indicated interest in reverting to risk-service contracts; negotiations are taking place to transition to these contracts. Foreign participation is not permitted in Petroecuador's extensive oil fields.

Ecuador has been unable to increase private investment in the petroleum sector in recent years, in part because of unfavorable economic terms, legal uncertainties, GOE tax policies, environmental liability concerns, and a lack of a coherent energy policy. State-owned Petroecuador's production increased slightly in 2008 through November, compared to the same period in 2007.

High profile legal cases brought by and against foreign oil companies have also dampened foreign investor interest. In 2005, President Palacio issued a decree requiring that all petroleum exploration and production contracts be renegotiated. In 2006 the Government of Ecuador made this decree law by amending its hydrocarbons law, unilaterally modifying the terms of oil production sharing contracts. In 2007, President Correa issued a decree increasing the State's share of extraordinary petroleum revenues under the 2006 amendment to 99%. On December 28, 2007, a new tax law was passed which sets the State's share of extraordinary petroleum revenues at 70% for contracts signed after the law goes into effect. Foreign oil companies in Ecuador argued that operations would not to be feasible under this scenario. In December 2006, April 2008, and June 2008, three U.S. companies initiated international arbitration proceedings based on the changes (while continuing to pursue negotiated solutions), as did other foreign oil companies. One of the U.S. companies reached agreement with the GOE to buy out its contract in August 2008 and has since left the country. The Government of Ecuador has initiated negotiations with the remaining foreign companies to renegotiate their contracts.

Private companies, including foreign ones, can participate in domestic fuel distribution, refining and transport activities. However, fuel prices are controlled by the central government. Ecuador has insufficient refining capacity to meet domestic demand for refined products and must import many oil derivatives.

Mining:

The mining sector is open to foreign investment, and foreigners have the same access to mining concessions as domestic investors. Foreign investors are prohibited from obtaining mining rights in zones adjacent to international boundaries without the permission of the President and the approval of the National Security Council of the Armed Forces (COSENA). Legislation and regulations were enacted (in 2000 and 2001) to encourage additional investment in the sector by eliminating government royalties, reducing the payment of surface rights per hectare, approving mining titles valid for all mining processes for 30 years, and streamlining the concession process. However, the validity of mining concessions under the 2000 law was called into question when the Ministry of Energy and Mines unexpectedly canceled some concessions in 2003. Investment in mining continues to be modest by Andean standards. Although rising commodity prices have led to an increase in mining investment in Ecuador in recent years, problems with local communities opposed to mining operations have caused periodic shutdowns. The Government of Ecuador has also temporarily suspended operating permissions for some concessions due to conflicts with communities. The mining mandate of April 2008 revoked over 4,000 mining concessions and suspended mining activity for six months. Major mining activity had not resumed as of January 2009. The Government of Ecuador has proposed a new mining law that was being reviewed by the legislative assembly in January 2009.

Fishing:

Foreign investment in domestic fishing operations is subject to approval by the National Fishery Development Council based on a favorable report from the National Fishing Institute. Extractive fishing by foreign companies is permitted provided that the catch is processed in Ecuador. The local sea cucumber population has been nearly eliminated, but shrimp, tuna and other fish products are harvested by national and foreign flag vessels and are major exports for Ecuador.

Electricity:

Amendments to the 1996 Electrical Sector Law adopted by the Ecuadorian Congress in 1998 authorized greater private participation in the electrical sector, but did not permit private firms to obtain majority control over any distribution, generation or transmission firms controlled by the state (the vast majority). Additional reform legislation passed in 2000 authorized private firms to purchase up to 51% of shares of government-owned electric distribution, transmission, and generation companies.

Electricity generators, including U.S. companies, face chronic problems in collecting accounts receivables from government-owned power distributors, which often operate at a loss. In 2007 the Government of Ecuador created a new Ministry of Electricity and Renewable Energy to focus more attention on the sector. A new electricity mandate issued in July 2008 establishes a single electricity tariff for distributors and consolidates the 19 state distributors into one. However, the mandate has not yet been implemented.

U.S. firms in this sector had been pursuing international arbitration; one won its arbitration and was paid an arbitral award in December 2008, and another reached a negotiated settlement with the government of Ecuador.

Telecommunications:

Basic telecommunications had traditionally been reserved for the state, but a 2002 law liberalized the sector. Two private groups with foreign participation were granted concessions in 1993 to develop cellular telephone systems. A third, state-owned company was granted a cellular concession in 2003. In 2004, US company BellSouth sold its assets in Ecuador to the Spanish company Telefonica. Satellite and paging services are also in private hands.

In 1998, Emetel, the former state telephone monopoly, was split into two corporations (Andinatel in the highlands and Pacifictel in the coastal region). Pacifictel has faced severe management challenges and has been the focus of several scandals. In September 2008, the National Telecommunications Council CONATEL approved the merger of Andinatel and Pacifictel, which are currently in the process of forming the Corporación Nacional de Telecomunicaciones. Detailed regulatory processes and delayed state company payments to the private sector continue to hinder foreign investors.

Media:

Foreign companies are prohibited from owning more that 25% equity in broadcast stations. Foreigners are not permitted to obtain broadcast concessions.

Strategic Sectors:

Other "strategic enterprises" are reserved for the state, including national security industries, in which the military often acts as a joint venture partner with private industry.

Conversion and Transfer Policies

In 2000, Ecuador adopted the U.S. dollar as its official currency. Since Ecuador adopted the dollar, inflation rates have declined from a high of near 100% to single digits. The rate of inflation from October 2007 to October 2008 was 9.85%.

Foreign investors may remit 100% of net profits and capital. Investors may also freely repatriate the proceeds from liquidation of their investments. There are no current limitations on outflows of funds for debt service, capital gains, returns on intellectual property, or imported inputs, other than the 2008 tax on capital outflows. There is also no significant delay for remitting investment returns such as dividends, return on capital, interest and principal on private foreign debt, lease payments, royalties and management fees through normal legal channels.

Ecuadorians may also export capital, and there are substantial Ecuadorian financial holdings in the United States and other offshore banking centers. In December, 2007, the Government of Ecuador passed a broad tax reform package, which included establishing a 0.5% tax on capital outflows. Transfers for imports, dividends on foreign investment, interest and principal payments on external debt registered with the Central Bank, and insurance premiums are exempt. In December, 2008, the tax on capital outflows was increased to 1% and the exemptions were eliminated.

Expropriation and Compensation

Expropriation is provided for in Ecuadorian law with appropriate compensation. In cases of expropriation, the individual has the right to petition a judge to establish an appropriate price for expropriated holdings. The Agrarian Development Law restricts the grounds for expropriation of agricultural land and makes land cases subject to regular courts. It can be difficult to enforce property and concession rights, particularly in the agriculture, mining and petroleum, commercial and residential real estate sectors. In some cases, Ecuador’s judicial system has failed to provide adequate protection from unlawful expropriations or provide investors and lenders with prompt, adequate and effective compensation for expropriated property.

Property, whether land or mobile assets jointly owned by several persons or companies, can be seized by Ecuadorian courts through judgments or seizure orders. U.S. citizens have had their assets seized because of judgments against their Ecuadorian partner in cases having no connection with the U.S. investor. Resolution and compensation typically require many years and significant legal costs.

Under Ecuador's bilateral investment treaty (BIT) with the United States, expropriation can only be carried out for a public purpose, in a nondiscriminatory manner, and upon payment of prompt, adequate and effective compensation. In 2004, a U.S. company won a $75 million international arbitration award against the Government of Ecuador. In March 2008, the government of Ecuador paid the award. . In 2006, Ecuador’s Solicitor General (Procurador General) initiated an investigation of the same company for allegedly transferring assets to another foreign company without obtaining the required government authorization. The government of Ecuador nullified the company’s contract and seized the company’s considerable assets in Ecuador. The U.S. company has initiated arbitration proceedings under the BIT; the government of Ecuador is participating in the proceedings. In September 2008, the arbitral panel ruled that it had jurisdiction over the case.

A number of U.S. companies operating in Ecuador, notably in regulated sectors such as petroleum and electricity, have filed for international arbitration resulting from investment disputes. Investors in more lightly regulated sectors have fewer disputes. In July, 2007, the World Bank's ICSID ruled against one U.S. electricity company's arbitration claim on jurisdictional grounds. The company has filed for an annulment of the ruling. In August 2008, another U.S. electricity company received a favorable arbitral award in its claim against the government of Ecuador. Two other companies reached negotiated agreements with the GOE regarding their arbitration claims in 2008.

The 2008 Constitution establishes that the State would manage land use and access to lands, while recognizing and guaranteeing the right to private property, "which should fulfill social and environmental functions." As of January, 2008, implementing laws to clarify this provision have not been issued.

Dispute Settlement

Systemic weakness and susceptibility to political or economic pressures in the rule of law constitute the most important problem faced by U.S. companies investing in or trading with Ecuador. The Ecuadorian judicial system is hampered by processing delays, unpredictable judgments in civil and commercial cases, inconsistent rulings, and limited access to the courts. Criminal complaints and arrest warrants against foreign company officials have been used to pressure companies involved in commercial disputes. There have been cases in which foreign company officials have been prevented by the courts from leaving Ecuador due to pending claims against the company. Ecuadorians involved in business disputes can sometimes arrange for their opponents, including foreigners, to be jailed pending resolution of the dispute.

The courts are often susceptible to outside pressure and bribes. Neither Congressional oversight nor internal judicial branch mechanisms have shown a consistent capacity to effectively investigate and discipline allegedly corrupt judges.

Despite efforts to depoliticize and modernize the court system, the resource-starved judiciary continues to operate slowly and inefficiently. There are over 55,000 laws and regulations in force. Many of these are conflicting, which contributes to unpredictable and sometimes contradictory judicial decisions. Enforcement of contract rights, equal treatment under the law, IPR protection, and unpredictable regulatory regimes are major concerns for foreign investors.

A number of foreign and local investors have had agricultural land seized by squatter groups over the years. The Embassy is aware of one instance in 2007 where an effort by squatters to seize land was blocked by local authorities. . Squatter groups also tried to seize land after Ecuador's new constitution was approved in late 2008; the government condemned those actions. The Embassy has not received any recent complaints about land being seized by squatters. In the past, the agrarian reform authorities often legally recognized squatter claims in the agricultural sector, with minimal or no compensation paid. Current agrarian law makes legalization of such seizures difficult and guarantees cash payment of the market value of the expropriated property.

Some local and foreign mining companies have had their concessions occupied by informal miners, who have subsequently sought a share of the concessions. Government entities, especially the state oil, telephone, and electricity companies, have violated their contracts with domestic and foreign private firms.

The U.S. - Ecuadorian BIT provides for binding international arbitration of disputes with the Government at the investor's option. Ecuador is a member of the International Center for the Settlement of Investment Disputes

(ICSID). In November 2007, the Government of Ecuador sent a letter to ICSID stating that it would no longer submit to ICSID jurisdiction for mining and petroleum matters, introducing additional uncertainty to the investment climate in the natural resources sectors. In early 2005, Ecuador modified the Arbitration and Mediation Law to prohibit international arbitration if the "national interest" could be affected. This modification appears to conflict with the terms of the BIT and, at a minimum, creates confusion among investors regarding their right to arbitration.

Ecuador's new constitution recognizes local or regional arbitration centers, or other forums as agreed to by the parties, and could limit arbitration options for investors, but these provisions have not been implemented. The new constitution also includes provisions which could limit the availability of international arbitration in new Ecuadorian investment treaties. These provisions do not appear to apply to existing treaties.

Performance Requirements and Incentives

There are no performance requirements associated with foreign investment in Ecuador. Except for "strategic" sectors described earlier, foreign investors are not required to have local equity participation. Visa and residence requirements do not inhibit foreign investment.

Under the Andean Community Common Automotive Policy, Ecuador, Venezuela and Colombia impose local content requirements on automobiles assembled in country in order to qualify for reduced duties on imports. The WTO Agreement on Trade-Related Investment Measures (TRIMS) prohibits such requirements. The local content requirement for passenger vehicles was 32 percent in 1997. It was raised to 33 percent for 1998, and was then lowered to 24 percent for 2000. Under the TRIMS Agreement, the three countries were obliged to eliminate local content requirements by 2000. However, in December 1999 the Andean Automotive Policy Council determined that it would not eliminate the local content requirement as it had initially indicated, but instead decided to increase it gradually to 35 percent by the year 2009. This revised automotive policy may be inconsistent with Ecuador's WTO obligations under the TRIMS Agreement.

Ecuador is a beneficiary of the Andean Trade Preferences and Drug Eradication Act (ATPA). The primary goal of this program is to promote export diversification and to provide sustainable alternatives to drug-crop production in the Andean region. ATPA created Ecuador's cut-flower boom, and also provided for duty-free exports of wood products, plywood, jewelry, and fruits and vegetables. The Andean Trade Preferences and Drug Eradication Act, which expanded the ATPA, provides Ecuador with duty-free access to the U.S. market in a number of new export categories in which Ecuador is competitive, including textiles, leather products, and pouched tuna.

The ATPA and its trade benefits have been extended until December 31, 2009.

Right to Private Ownership and Establishment

Foreign and domestic private entities can own business enterprises and engage in almost all forms of business activity. Private entities can compete freely with the public sector in most areas, although in some cases the Government has clearly favored state-owned enterprises in awarding its business. In August 2008, Ecuador's Constituent Assembly passed a new public contracting law, which calls for priority for locally produced products and services in public purchases, although foreign suppliers can compete for the contracts. The government has not yet defined how it will establish priority for Ecuadorian suppliers. The law eliminates the former requirement to obtain approval from the Attorney General and the Controller prior to being awarded a government contract, and creates a National Institute of Public Contracting to oversee transparency and timeliness of the contracting process.

Protection of Property Rights

There have been numerous instances where the judicial system has not adequately protected property owners' rights. U.S. investors in real estate should exercise caution when considering a land purchase in Ecuador.

Ecuador's intellectual property regime is governed by the "Law on Intellectual Property" adopted in 1998. The law provides criminal and administrative relief to right holders. Ecuador has ratified the Berne Convention for the protection of literary and artistic works, the Geneva Phonogram Convention, and the Patent Cooperation Treaty. Ecuador is also bound by the Andean Community Decisions 345, 351, and 486. Decision 486 improves intellectual property protection by expanding the definition of patent ability and strengthening data exclusivity. In April 2001, the U.S. Trade Representative (USTR) removed Ecuador from its Special 301 Watch List to reflect improvements in Ecuador's intellectual property regime. However, weakened enforcement (particularly in the area of pharmaceuticals) led to Ecuador's re-listing in 2003. At the end of 2008, Ecuador was still listed on the Watch List. Ecuador made a public commitment to apply the WTO TRIPS agreement from the date of its accession to the WTO.

In 2004, the Andean Community confirmed the legality of a Colombian decree reinforcing data exclusivity rules and intellectual property rights. This decision removed key conflicts between Andean Community rules and Ecuador's WTO commitments, theoretically reinforcing the legal protections for intellectual property rights. However, Ecuador continues to issue sanitary registrations to illegal copies of patented products, and at times has relied on test data that the original producing company maintains is protected by data confidentiality.

Enforcement against intellectual property infringement remains a serious problem in Ecuador. The national police and the customs authority are responsible for carrying out IPR enforcement orders, but it has sometimes been difficult to have court orders enforced. There is a widespread local trade in pirated audio and video recordings, computer software and counterfeit activity regarding brand name apparel. On the other hand, local registration of unauthorized copies of well-known trademarks has been reduced.

Patents:

The IPR law extends patent protection for 20 years from the date of filing. Patenting of pharmaceutical products is permitted. Provisions for compulsory licensing are limited. In infringement cases, the burden of proof lies with the alleged infringer. The law also provides patent protection for new drugs. Although Andean Community Decision 486, issued in late 2000, represents a significant improvement over Decision 344, it still does not provide adequate protection for "second use" patents.

Producers of branded pharmaceuticals are concerned that the "Law on Generic Drugs", which was passed in 2000, enshrines discrimination against branded pharmaceuticals into law. The law mandates that Government entities buy only generic drugs. The law also lowers drugstore gross profit margins on branded medicines to 20%, while maintaining the margins for generic drugs at 25%. Under the law, drugstores are also required to devote a certain percentage of shelf space to generic pharmaceuticals. The GOE has proposed to further reduce allowable profit margins on pharmaceutical sales, but no final action has been taken in that regard.

Copyrights:

Printed and recorded works are in theory protected under the IPR law for the life of the author plus 70 years. Computer programs and software are also protected. However, pirated CDs and DVDs are readily available on many street corners and even in shopping malls. The Government of Ecuador, through the IEPI's Strategic Plan against Piracy, has committed to take action to reduce the levels of copyright piracy, including though implementation and enforcement of its 1998 Copyright Law. However, weak copyright enforcement remains a significant problem, especially concerning sound recordings, computer software and motion pictures. Sellers of pirated goods sell their illegal wares with little fear of prosecution. The Government of Ecuador has not taken action to clarify that Article

78 of the 1999 Law on Higher Education does not permit software copyright infringement by educational institutions.

Trademarks

Trademark registration is permitted for renewable 10-year periods, but registration may be canceled if the mark is not used in the Andean region for a period of three years. The IPR law provides protections for well-known trademarks. A trademark registration cannot be cancelled without the consent of the trademark owner.

Other Protection:

The IPR law provides protection for industrial designs and extends protection to industrial secrets and geographical indicators. Semiconductor chip layouts are protected. Plant varieties and other biotechnology products are also, in theory, protected.

Registrations and Enforcement:

The Ecuadorian Intellectual Property Institute (known by its Spanish acronym IEPI) was established in January 1999 to handle patent, trademark and copyright registrations on the Ecuadorian Government's behalf. IPR enforcement has improved although piracy remains. The Ecuadorian National Police and Customs are responsible for carrying out IPR enforcement orders. IEPI has had to reduce funding and staffing for enforcement. However, the enforcement office was reorganized in 2007 in an effort to strengthen enforcement, and funds have been designated to train the staff in enforcement. IEPI has embarked on an initiative to enhance intellectual property awareness in children and young adults by providing educational materials on the protection of intellectual property to several hundred schools.

IEPI and Ecuadorian Customs have increased enforcement actions in their areas of competence where they can act without a formal complaint by the right-holder, through administrative sanctions imposed by IEPI or interception of counterfeit goods by Customs.

Transparency of Regulatory System

Ecuador's regulatory system is not transparent. There are no antitrust laws and industry is fairly concentrated. The Government of Ecuador has indicated that it is preparing a competition law, but has not made it available for public review.

The Superintendent of Banks and Insurance (SBI) regulates financial and insurance institutions. The 2008 Constitution calls for the creation of new regulatory agencies for the informal financial sector. The new Constitution also mandates that each financial institution have an ombudsman office. The regulatory authorities that were formerly autonomous now fall directly under the Executive. Under a law, approved by the legislative assembly in December 2008 but not finalized as of January 2009 because of partial vetoes, the Executive Branch would seek to improve coordination of the financial regulatory agencies by having both the Central Bank and the SBI as members of the new corporations that will manage a new liquidity fund, deposit insurance agency and resolution system. The National Council of Radio Broadcasting and Television (known by its Spanish acronym CONARTEL) regulates broadcasters. The Superintendent of Telecommunications regulates fixed-line and wireless communication services. The Superintendent of Companies regulates all other firms and, via the National Securities Council, the stock markets.

Policies, regulations and standards, particularly in regards to agricultural trade, often are not based on scientific principles and discriminate between local and imported products. Political appointees in the Ministries of Agriculture and Health control imports of agricultural goods, and customs procedures are cumbersome. Ecuadorian regulators provide little or no opportunity for public comment on newly proposed laws and regulations, particularly those related to food safety, sanitary and phytosanitary and other trade-related matters. Ecuador does not comply with the WTO notification requirement.

In addition, ministries, parastatals, and regional and municipal governments all impose their own requirements and regulations on commercial activity. In the World Economic Forum's 2008 Competitiveness Index, Ecuador ranked 104 out of 134 countries surveyed.

Efficient Capital Markets and Portfolio Investment

The 1993 Capital Markets Law set up a modern regulatory structure, opened stock market trading to banks and other firms, and encouraged the development of mutual funds. However, Ecuadorian capital markets remain underdeveloped. Most large industrial groups are privately held, and are financed largely through debt or retained earnings. The bulk of activity on the country's two small stock exchanges currently involves trading in short-term commercial paper, bank obligations, and government debt. Regional rivalries complicate efforts to develop a truly efficient capital market in Ecuador's small market.

Most stock trades involve shares in a handful of banks and companies. Bank credit on market terms is available and improving; rates have been decreasing. The private sector has access primarily to short-term bank credit, approximately 70% of the loan portfolio has a maturity of less than one year and approximately – 60% of the resources are demand deposits. Most of Ecuador's blue-chip firms maintain external credit lines or other forms of foreign financing.

In July 2007, Congress approved a law to establish a new methodology to calculate interest rate ceilings for bank loans and eliminate non-interest commissions. The GOE has introduced new legislation (currently under discussion), modifying the methodology and giving authority to the Central Bank to set the rates. The financial sector continued to grow in 2008. Deposits increased by 28.44% from November 2007 through November 2008, while the total outstanding loan portfolio increased by 27%, during the same time period.

Political Violence

Ecuador does not have a tradition of widespread political violence or guerrilla activity. Crime is a serious concern, especially in the larger cities.

Student, labor union and indigenous protests against government policies are a regular feature of political life in Ecuador. While disruptive, especially to transportation, violence is usually limited and localized. Protesters often block city streets and rural highways, and public transportation tends to be disrupted during these incidents. Protestors also occasionally burn tires, throw Molotov cocktails, engage in destruction of property and detonate small improvised explosive devices during demonstrations, but fatalities as a result of protests have been rare. Pamphlet bombs are sometimes used to disseminate political literature. Popular protests in 1997, 2000 and 2005 contributed to the removal of three elected presidents before the end of their terms. Some communities have successfully used protests and strikes to obtain promises of increased government spending on social benefits and infrastructure. Some indigenous communities opposed to development have protested to block access by petroleum and mining companies. It is against the law for foreigners to engage in political activity that starts or promotes civil wars or international conflicts. In 2008, there were at least two incidents where protestors complained of possible excess force used by the police to disperse protests against government officials.

Kidnappings have occurred and foreigners have been targeted. The political violence present in neighboring Colombia can have a spillover effect in northern Ecuador. Since 1998, at least 10 U.S. citizens have been kidnapped. The U.S. Embassy in Quito advises against travel to the northern border of Ecuador – to include the provinces of Sucumbios, Orellana and Carchi and parts of Esmeraldas Province. However, kidnappings are more often economically than politically motivated. In October 2000, kidnappers seized several foreign oil workers in Eastern Ecuador. After murdering one of their American hostages in January 2001, they released the other victims upon receipt of a ransom payment.

Violent crime has significantly increased in 2007 and 2008, with American citizens being victims of crimes, to include, but not limited to, homicides, armed assaults, robberies, sexual assaults, and home invasions.

Businesses continue to report being extorted for protection money. Security on the northern border with Colombia, where the majority of Ecuador's oil deposits are located, is particularly tenuous. The area is used as a transshipment point for precursor chemicals used in illegal drug protection as well as arms and supplies for Colombian insurgent groups and narco-traffickers. The Ecuadorian military and government agencies are increasing efforts to promote development and provide security in this area.

Corruption

Corruption is a serious problem in Ecuador. Transparency International consistently ranks Ecuador near the bottom among countries it surveys in the region. Ecuador ranked 151 out of 180 countries surveyed for Transparency International's Corruption Perceptions Index 2008 and received a score of 2 out of 10 (10-highly clean, 0-highly corrupt). In the Western Hemisphere, only Venezuela and Haiti received lower scores than Ecuador.

Ecuador has laws and regulations to combat official corruption, but they are inadequately enforced. Illicit payments for official favors and theft of public funds take place frequently. Dispute settlement procedures are complicated by the lack of transparency and inefficiency in the judicial system. In addition, local authorities often demand "gratuities" to issue necessary permits.

Offering or accepting bribes is illegal and punishable by imprisonment for up to five years. The Controller General of the Nation is responsible for the oversight of public funds and there are frequent investigations and occasional prosecutions for irregularities. These investigations can be politically motivated. Autonomous agencies are subject to little effective oversight. Government officials and candidates for office often make an issue of corruption, but there is little follow through. Politically motivated corruption scandals are a feature of Ecuadorian political life, but even high-profile cases often become stalled after they are remanded to lengthy and often inconclusive judicial proceedings.

Ecuador is not a signatory to the OECD Convention on Combating Bribery, nor has Ecuador complied with the main requirements of the OAS Inter-American Convention Against Corruption. The 2008 Constitution created the Transparency and Social Control branch of government, tasked with preventing and combating corruption, among other things.

The 2008 Latin American Public Opinion Project (LAPOP), found that Ecuadorians rated 6th in Latin America in both the frequency with which they were victimized by corruption, and their perception of the prevalence of corruption.

Bilateral Investment Agreements

The U.S. - Ecuadorian Bilateral Investment Treaty (BIT) provides for national treatment, unrestricted remittances and transfers, prompt, adequate and effective compensation for expropriation, and binding international arbitration of disputes. However, in early 2005, Ecuador modified the Arbitration and Mediation Law in an attempt to prohibit international arbitration if the "national interest" could be affected; the current government has also sent mixed signals with respect to allowing for at least some types of international arbitration in future energy sector contracts, and has indicated it may seek to review arbitration provisions of existing BITs. The 2008 Constitution could limit future international arbitration options.

OPIC and Other Investment Insurance Programs

Ecuador has had an Investment Guarantee Agreement with the Overseas Private Investment Corporation (OPIC) since 1986. Ecuador has signed and ratified the Multilateral Investment Guarantee Agreement (MIGA).

Labor

Ecuador's population was 13.5 million in 2006, according to census data. Semiskilled workers are relatively abundant at low wages, although widespread emigration over the past few years has led to shortages of skilled workers in some parts of the country. Minimum compensation levels are set by the Ministry of Labor according to the job and industry and can be adjusted by Congress. The minimum compensation package was about $170 per month in 2007. In 2007, Ecuador's Central Bank estimated the average unemployment rate at 9%. However, the national underemployment rate is estimated at over 50%.

Ecuador's economic woes have contributed to high levels of emigration in recent years. An estimated 1,000,000 people, or 17.2% of Ecuador's labor force, emigrated between 1999 and 2005, principally to Spain and the U.S.

The public education system is tuition-free, and attendance is mandatory from ages six to 15. In practice, however, schools often require parents to pay for education-related expenses such as to cover children's books, school's utility bills, and transportation costs. Many children drop out before age 15 and in rural areas only about one-third complete sixth grade. The government is striving to create better programs for the rural and urban poor, especially in technical and occupational training. However, government funding for such training has not kept up with demand. In recent years, it also has been successful in reducing illiteracy. Enrollment in primary schools has been increasing at an annual rate of 4.4% -- faster than the population growth rate. According to the current constitution, the central government must allocate at least 30% of its revenue to education; in practice, however, it allots a much smaller percentage. Public universities have an open admissions policy. In recent years, however, large increases in the student population, budget difficulties, and politicization of parts of the university system have led to a decline in academic standards.

A weak public university system produces a surplus of semi-qualified graduates in the professions. Trained financial professionals and engineers can be difficult to attract and many graduates require additional training to reach international standards. There are relatively few R&D and high technology investments in Ecuador, limited mostly to agricultural research, with a small amount of government activity as well as that of some foreign firms. Little post-graduate education exists in Ecuador, and scientists and medical professionals are nearly all foreign-trained. At this point, none of the Ecuadorian universities offer doctorate programs beyond limited offerings in social sciences at two institutions. Masters-level degrees are widely offered, but relatively few are of international competitive levels of quality. Upper-level Ecuadorian business managers have frequently been educated abroad, most often in the United States.

Cumbersome labor regulations apply equally to both foreign and domestic firms and tend to inhibit investment and foster evasion. Legal changes to modernize the country's Labor Code were passed by Congress in 2000 as part of omnibus economic reform legislation. However, the Constitutional Tribunal declared virtually all of the changes unconstitutional. In 2006, the Labor Ministry worked with an ILO representative to draft a revised Labor Code to better comply with ILO standards. The Labor Code provides for a 40-hour work week, 15 calendar days of annual paid vacation, restrictions and sanctions for those who employ child labor, general protection of worker health and safety, minimum wages and bonuses, maternity leave, and employer-provided benefits. By law, companies must distribute 15% of pre-tax profits to their employees.

The 2008 Constitution bans child labor, favors workers with disabilities, and reduces allowed strikes in the public sector. Provisions that virtually eliminate hourly labor contracts and labor contracts through third parties are aimed at employers avoiding benefits for full-time employees, but reduce flexibility in the labor market.

Most workers in the private and parastatal sectors have the constitutional right to form trade unions and local law allows for unionization of any company with more than 30 employees. Less than 10% of the urban work force, mostly skilled workers in medium- to large-sized enterprises or state industries, is officially organized. Private employers are required to engage in collective bargaining with recognized unions. The Labor Code provides for resolution of conflicts through a tripartite arbitration and conciliation board process. The Code also prohibits discrimination against union members and requires that employers provide space for union activities.

The International Labor Organization and prominent NGOs believe international labor standards are not respected in Ecuador. Workers fired for organizing a labor union are entitled to financial indemnization, but the law does not mandate reinstatement.

Except for public servants and workers in some parastatals, workers by law have the right to strike. Legally striking employees are entitled to full pay and benefits and may occupy the premises under police protection, although there are restrictions on solidarity strikes. Most public sector employees are technically prevented from joining unions, but most are members of a labor organization and most labor actions are in fact illegal strikes by public employees. Although trade union political influence has declined in recent years, the Unified Workers Front (FUT), the teachers' union (UNE), and other labor groups occasionally attempt to stage national strikes to protest the modernization process and economic reform measures. From January through November 2006, the number of strikes and local conflicts decreased approximately 36% from those in the same period in 2005, according to national police records.

With assistance from the ILO, Ecuador has been taking steps to eliminate child labor, which is still common in many industries.

As of August 2007, the Department of Labor had issued 100 citations to companies in violation of the Child Labor Law. These actions were a direct result of Ecuador hiring 29 full-time child labor inspectors and six support staff in 2006 tasked with conducting unannounced inspections. The Department of Labor is expected to hire additional inspectors.

Economic realities leave families more than ready to send their boys, and sometimes girls, out to work, even if it means pulling them out of school and placing them in fields, mines or factories where they are exposed to hazardous conditions for little or no pay. The International Labor Organization estimated that 69,000 children ages 10 to 14, and an additional 325,000 young people ages 15 to 19, were working in agriculture in 1999, the year of Ecuador's most serious economic crisis in recent decades. Anecdotal evidence indicates that these figures have dropped since 1999, aided substantially by the economic recovery and more recently by the hiring of additional child labor inspectors in 2006. However, labor advocates in Ecuador assert that only a significant increase in wages will keep families from sending their children to work in the fields. The ILO's most recent child labor data dates from 2001.

The National Statistics Institute records that there were more than 50,000 under age workers in 2007, or 9% of the total labor force. Of this total, 63% were under fifteen years old and 70% were working in agriculture.

Foreign-Trade Zones/Free Ports

A free trade zone law was passed in 1991 in order to promote exports, foreign investment and employment. The law provides for the import of raw materials and machinery free of duty and tax; the export of finished and semi-processed goods free of duty and tax; and tax exemptions for business activities in the government-established zones. Foreign investments in free trade zones are exempt from future restrictions on capital repatriation. Free trade zones may be used for industrial or commercial activities. Companies establishing operations in free trade zones are required to pay a fee equal to 2% of their investment to the National Council of Free Trade Zones. However, persuading Ecuador's tax authority to respect the tax benefits conferred by the free trade zone law is burdensome and time consuming. As a consequence, free trade zones are few and largely unimportant to the economy. Free trade zones have been established in Esmeraldas, Manabi and Pichincha provinces, and a zone is planned for the site of the new Quito airport.A maquila (in-bond processing) law has been in effect since 1990. The majority of maquila operations in Ecuador are in the textile and fish-processing sectors.

Foreign Direct Investment Statistics

Foreign investment in Ecuador remains concentrated in the oil sector. The construction of the Trans-Andean Heavy Oil Pipeline (OCP), completed in October 2003, accounted for much of this investment. This massive construction project carried out by a consortium of five foreign oil producers resulted in inward investment of $3.5 billion, including direct project investment of $1.4 billion. Subsequent investment in oil production to fill the OCP has not materialized due to lack of a GOE oil sector development policy, the contract nullification and seizure of assets belonging to a major U.S. oil company, and Ecuador's demand that all oil contracts be renegotiated. Foreign direct investment (FDI) outside the oil sector remains modest and is focused on mining, financial services, food processing, the chemical and pharmaceutical industries, and machinery and vehicle manufacturing. Overall net FDI flows totaled approximately $193 million in 2007.

The United States is the major source of foreign investment capital. The petroleum sector accounted for the lion's share of this inflow.

The largest foreign investors in Ecuador are petroleum companies engaged in exploration and production, including gas company Noble Energy.(U.S.) Andes Petroleum and CNPC International (Chinese), YPF/Repsol (Spain), AGIP (Italy), Perenco (France) and Petrobras (Brazil). U.S. oil service company Baker Hughes is also present. U.S. firms Duke Energy and Noble Energy subsidiary Machala Power are active in the electrical sector. Exxon Mobil (U.S.) and Shell (Holland/UK) distribute fuels at service stations across the country. U.S. citizens have also invested in the textile and agricultural sectors (flowers, fruit and vegetables).

American firms active in the manufacturing sector include: General Motors, which holds an interest in two automotive assembly plants, Philip Morris (cigarettes) and Bristol-Myers Squibb (medications), Among third country investors, General Tire (Germany) manufactures tires, Holderbank (Switzerland) produces cement, Akzo Nobel (Netherlands) makes fibers and textiles, Borden (Netherlands) manufactures chemicals, and Eternit (Switzerland) fabricates construction materials.

There are several American pharmaceutical companies operating in Ecuador, including: Schering Plough, Bristol-Myers Squibb, Merck Sharp & Dohme, Wyeth Consumer Healthcare, Abbott, Janssen Pharmaceutical, Eli Lilly, and Pfizer. Baxter has seven renal units in the country. U.S. firms Colgate-Palmolive and Kimberly Clark manufacture toiletries and cleaning products. Also present are: 3M (consumer goods), Proctor & Gamble (personal care products), Kellogg's (cereal). British SAB Miller owns the major brewery. Nestle (Switzerland) and Kraft (U.S.) are leading food product manufacturers, while a number of other foreign firms have invested in processing facilities for non-traditional vegetables and fruits. Continental Flour (U.S.) and Seaboard Flour (U.S.) have closed some of their operations and consolidated operations by entering joint-venture agreements with local companies. Continental, along with several other U.S. firms, is a major investor in shrimp farming. Standard Fruit/Dole (U.S.), Chiquita Banana, and Del Monte are involved in the banana industry from production to marketing and shipping. Several U.S. franchise chains are now operating in Ecuador, including Tricon (Pizza Hut/Kentucky Fried Chicken/Taco Bell), Burger King, McDonalds, Tony Romas, TGI Friday, Papa John's, Chili's, Romano Maccaroni, Domino's Pizza, Heel Quick, Swisher, Gymboree, Fast Track Kids, and New Horizons. Citibank (U.S.) and Lloyd's (U.K.), have commercial banking operations, while Helm Bank (U.S.) has a representation office in Ecuador. U.S. airlines Delta, Continental, and American, as well as hardware and software (IBM, Xerox, Microsoft),insurance (ACE, Pan-American Life, BMI, AIG), consumer goods (3M), personal care products (Proctor & Gamble), cereal (Kellogg's), and advertising (McCann Erickson) companies are also active.

Net Flows of Foreign Direct Investment (In Millions of Dollars)

Investment Statistics Table (million of $)[1]	**2003**	**2004**	**2005**	**2006**	**2007**
Net flow of FDI	871.51	836.94	493.41	270.72	193.29
FDI Net flow/GDP (%)	3.04%	2.56%	1.33%	0.65%	0.42%
FDI net flow (by Country of origin):					
Cayman Islands	438.22	31.58	-1.64	-9.59	-356.62
US	-47.33	78.54	-77.20	-159.79	108.72
Bahamas	78.59	113.71	28.33	-17.43	-111.73
Panama	85.10	93.54	76.20	66.72	78.33
France	70.21	14.77	-755	8.43	77.52
Brazil	4.89	188.53	288.06	368.91	75.85
Spain	3.33	631	2.68	6.87	72.23
China	19.69	-7.68	-19.91	11.94	59.79
By Sector Destination:					
Oil/Mining	148.55	385.37	198.35	-116.62	-122.05
Manufacturing	78.98	114.93	75.42	90.16	94.57
Commerce	78.14	103.15	72.46	32.30	77.80
Transport and Communications	439.10	73.70	17.50	83.32	-52.50
Agriculture	49.91	72.91	23.93	47.31	24.12
Services	71.06	39.95	73.83	89.36	116.76
Construction	3.49	39.22	7.43	8.45	32.94
Others	2.28	7.70	24.49	36.43	21.64

Notes:

1: All figures are listed in millions of dollars unless otherwise noted. Data is from the Central Bank of Ecuador. The Central Bank has changed the methodology used to calculate FDI, and now only publishes net flows.

Source: Central Bank of Ecuador

Web Resources

Ministry of Foreign Trade – Foreign Trade & Investment Council **www.comexi.gov.ec**

Central Bank of Ecuador - Foreign Investment Department **www.bce.fin.ec**

Superintendence of Companies **www.supercias.gov.ec**