



QUICK FACTS: **ECUADOR DEBT TIMELINE AND COMMISSION FINDINGS**

December 9, 2008

Ecuador's Debt and the Global Financial Crisis

The current financial crisis and the third world debt crisis which began in the late 1970s both share a similar cause: reckless and irresponsible lending. In the current financial crisis, the sub-prime mortgage industry extended too many risky, irresponsible loans, which contributed to the financial crisis we face today. Likewise, commercial lenders extended credit to developing nations with scant regard for a nation's capacity to repay or the quality of the loans in the late 1970s, which led to the Third World debt crisis of the 1980s. Developing nations across Asia, Latin America, and Africa continue to suffer the ill effects of the third world debt crisis which began more than 25 years ago.

The case of Ecuador is not unlike many other developing countries: impacted originally by the third world debt crisis, it is beginning to feel the impacts of the current crisis. The origins of Ecuador's debt date to the period between 1976-1979, when, under the dictatorship of the Supreme Government Council, Ecuador contracted \$3.4 billion in debt. Of this nearly two-thirds was used to finance military expenditures. After multiple reschedulings, conversions and further borrowing, Ecuador's external debt has risen to more than \$10 billion today. By now, Ecuador has more than repaid the principal it borrowed plus significant interest and penalties.

Ecuador's continuing debt service payments are impacting its economy and the well-being of its population. **In 2007, Ecuador paid \$1.75 billion in debt service, more than the government spent on health care, social well-being, housing and urban development, and the environment combined.** As part of its plan to fight poverty, the Ecuadorian government has made a public commitment to reverse this situation by 2010, seeking to significantly increase its spending on social services while cutting the amount it pays on debt service.

In this context, the government of Ecuador established the independent Public Debt Audit Commission in July 2007, to examine the origins, nature, and impacts of the country's sovereign debt. The commission completed a report in September 2008 which documents claims of irregularities and illegitimacy in the contraction of Ecuador's public debt. On November 20, Ecuadorian President Rafael Correa announced that the government was delaying a payment on its Global 2012 bonds, invoking a 30-day grace period allowed in the bond contract. At the end of the 30 days, the Ecuadorian government defaulted on the debts.

As policymakers look for global solutions to the problem of irresponsible lending in the current financial crisis, the case of Ecuador points to an important blind spot: the lack of an international, independent mechanism for countries to question potentially illegitimate and/or illegal debt or to petition in the case of an inability to pay. This vacuum essentially forces a country such as Ecuador, which has found serious issues regarding its debt (*detailed below*), into a corner with two possible options: restructuring or default. An independent body should be created to address this issue – while Ecuador is the first developing country during the current crisis to consider default -- it is unlikely to be the last given the severity of the global recession.

Ecuador Debt Timeline

Ecuador's independent Public Debt Audit Commission found and documented hundreds of irregularities in the contraction of debt over the past 32 years. The timeline below provides a history of the debt and some examples of irregularities cited in the Commission's 172-page report, which was presented to the Government of Ecuador on November 20, 2008.

Timeline:

| | |
|---------------------|--|
| 1976-1979 | The Dictatorship of the Supreme Government Council assumes \$3.4 billion in loans. Military spending made up two thirds of this amount. |
| 1980s | Debt re-negotiation during the presidential terms of Osvaldo Hurtado Larrea and León Febres. In this agreement, Ecuador renounces its right to any defense or immunity guaranteed by the <i>Foreign Sovereign Immunity Act</i> . |
| 1987-1992 | Suspension of debt payment due to a financial crisis. |
| 1992 | Ecuador signs a "Tolling Agreement" under which it re-commits to repayment. Days before the lender's statutory right to enforce collection of the loan is due to expire, Ecuador suddenly agrees to repay approximately \$7 billion in loans. The propriety of this action is questionable. |
| 1994 | Signing of the Brady Plan, which restructures Ecuador's debt. Brady Bonds are issued at a total value of \$6 billion. |
| 1999 | Suspension of Brady Bonds payment due to a financial crisis. |
| 2000 | The debt is restructured through the issuance of Global Bonds. |
| 2007 | Creation of an independent, international Public Credit Audit Commission (CIAC) to analyze Ecuador's debt. |
| Nov 20, 2008 | The Commission presents its findings to the Ecuadorean Government. |

Summary of Irregularities Cited by the Commission

Engaging in a year of analysis and research **the commission took a comprehensive approach to Ecuador's debt and reviewed the country's debts to commercial creditors, multilateral banks, and bilateral donors. In his statement on November 20, President Rafael Correa highlighted one particular commercial credit – the Global 2012 bonds – to be particularly problematic.** Some of the alleged irregularities cited by the Commission in their 172-page final report regarding the negotiation of the Global Bonds include the following:¹

- Representatives from Salomon Smith Barney and JP Morgan interfered in negotiations over the Global Bonds — without Ecuador's authorization.
- The issuers of the Global Bonds may have violated rules regarding the registration of public offerings, which are subject to regulation by the U.S. Securities and Exchange Commission (SEC).
- The agreement that gave rise to the Global Bonds and the Bonds themselves may not be legal under Ecuador's constitution, which prohibits an individual from incurring debt on behalf of the country.
- Brokers received immunity from any liability related to sale of the Global Bonds — freeing them of all risk and leaving Ecuador without any remedy.

The Ecuador audit commission documents that the way the bonds were issued, rolled over, and reissued violated various Ecuadorian national laws including the Ecuadorian constitution, the civil

¹ See page 81 of the Spanish version of the Commission's final report, available online at: http://www.auditoriadeuda.org.ec/images/stories/documentos/informe_final_CAIC.pdf

code, the commercial code, and the law of finance and administration. The commission also argues that the contraction of the Global bonds also violated general principles of international law including good faith and the prohibition against fraud.

More broadly, the commission report documents the circumstances under which creditors took advantage of the country: “Multilateral organisms, foreign banks, and other lenders, with the participation of national authorities and officials, imposed their conditions on the country, forced it to accept a higher level of debt and successive ‘restructuring’ procedures that were not transparent and that generated the transfer of private debts to the State...”

Forced into a corner: Ecuador challenges its debt

Confronted with strong claims of the illegality and/or illegitimacy of some of its debt and mounting political pressure to free up resources to invest in social services given the current crisis, the Ecuadorian government faces a difficult decision of how to respond. But the current global regulatory framework offers Ecuador no good options. There’s no fast and efficient way to reach all bondholders without endangering the social well-being and economy of the country. Within the existing legal and regulatory framework governing sovereign borrowing, there’s no efficient or comprehensive way for Ecuador to lodge its complaint about the possible illegitimacy of its debt. This is a failure of the global financial system which forces countries to consider default. It points to the urgent need for a global framework to make debt work out process more orderly.

Current Status: December 15 Decision Deadline

The Ecuadorian Government, with assistance by U.S. law firm Foley Hoag LLP, is investigating the legal and international implications of the alleged irregularities cited by the Commission. The government is also considering possible criminal prosecution against the individual authorities responsible for the debt. The 30-day grace period for the next payment on the Global Bonds ended December 15, 2008 and the Government defaulted at that time.

Jubilee USA is an alliance of 75 religious denominations and communities, development agencies, and human rights groups working for poor country debt relief and more responsible global finance.