BRI MONITOR

POLICY BRIEF: CHINA'S LOANS IN ECUADOR

BRI Monitor is a global initiative to track the impact of China's Belt and Road Initiative projects, involving a coalition of independent think tanks and civil society organizations across Asia-Pacific, Central Asia, and Africa. A key aim is to promote transparency and accountability around the terms and full costs to countries and communities. With support from the Center for International Private Enterprise, BRI Monitor partners developed a new methodology to assess the level of disclosure about various infrastructure projects and contract data. This can help identify governance gaps that make countries vulnerable to corrosive capital situations.

CHINA'S INFLUENCE ON ECUADOR'S GOVERNANCE AND DEVELOPMENT

The Ecuadorean National Assembly's ratification of a free trade agreement with China on February 7, 2024, marked the latest development in a deepening economic relationship between the two countries. Growth in the relationship took off during the administration of Ecuador's former President Rafael Correa (2007-2017), following his government's 2008 default on $3.2 billion of what he claimed was "illegitimate" sovereign debt. The default led other lenders to pull back and left Ecuador increasingly dependent on Chinese finance. Since 2010, Ecuador has received $18.2 billion worth of loans from China's primary development finance institutions, the China Development Bank (CDB) and the Export-Import Bank of China, making China the country's largest bilateral creditor.

Ecuador stands out for accepting more loans—24 since 2010—from China's development finance institutions than any other country in Latin America. While the loans have helped the country build roads, dams, and other infrastructure, the results have often delivered fewer benefits than promised and have strained Ecuador's finances. The Ecuadorean experience is a cautionary tale for other states in Latin America and high-risk countries around the world that face challenges in accessing international finance for their development. Ecuador provides lessons and insights into some of the risks other states may encounter when dealing with Beijing. This month's edition of the *BRI Monitor Policy Brief* explores the consequences for economies and for democratic governance when appropriate safeguards are ignored or nonexistent.

OIL-FOR-LOAN DEALS AND THEIR ECONOMIC CONSEQUENCES

Ecuador agreed to repay several of its Chinese loans in oil, committing the country to sell as much as 80% of its oil exports to China at below-market prices and costing Ecuador valuable revenue that it could have otherwise used to pay down its debts or provide public goods to its citizens. At the same time, China has been able to resell the oil it receives from Ecuador for a profit; in July 2022, the price difference was $11 per barrel. Fortunately, Ecuador has managed to reduce some of its future losses by renegotiating its contracts.

Another consequence of the oil-for-loan deals has been to redouble Ecuador's reliance on oil extraction for growth. In 2014, *The Guardian* released an internal Ecuadorean government document purporting to show that Quito was privately negotiating a $1 billion loan from CDB in exchange for giving PetroChina—a Chinese state-owned oil and gas company—the rights to drill underneath Yasuni National Park, one of the country's most biodiverse areas. The document dated from 2009, a time when Ecuador's government was publicly promoting its now-defunct Yasuni-ITT Initiative that was meant to protect the park and the Indigenous people living there. The Ecuadorean government proceeded with exploration in Yasuni after abandoning the initiative. To its credit, the government has so far respected a 2023 referendum in which Ecuadoreans voted by a 17 percentage-point margin to ban oil extraction in the park. Even so, Ecuador has a long history of collaborating with foreign resource extractors, including Chinese mining conglomerates, to strong-arm indigenous peoples into opening their land for exploitation.

Reinforcing Ecuador's dependence on oil exports may also have a negative impact on the country's long-term economic outlook. Research from Harvard University's Center for International Development shows a strong correlation between a country's economic complexity—as measured by the type and number of products it can produce and export—and its prospects for future growth. Ecuador has consistently ranked poorly on measures of economic complexity and underperformed relative to its peers over the past decade following a period of improvement in the mid-2000s. In other words, more resources devoted to oil extraction means fewer resources are available to develop expertise in other industries that will help Ecuador grow and improve its resilience to negative economic shocks.

HOW OPAQUE LOANS ENABLED CORRUPTION AND UNDERMINED THE RULE OF LAW

At $1,000 per capita, Ecuador has one of the highest debt loads from China's policy banks in Latin America. As CIPE has shown through its own research on the impacts of corrosive capital in the region, these loans operate under opaque practices—the CDB does not typically disclose the terms of its loans—and enable corruption and bribery. In February 2023, for example, 37 people including Ecuador's former president Lenin Moreno were indicted on charges of accepting bribes of up to $76 million in a scheme related to the Coca Codo Sinclair dam project, which was funded with a $1.7 billion loan from China Ex-Im Bank. Even the anti-corruption official monitoring the project, Carlos Pólit, was accused of accepting bribes to overlook construction failures that, among other problems, led to the deaths of 13 workers when a tunnel collapsed. An executive at Odebrecht—a Brazilian construction firm that has admitted to paying millions in bribes to officials around the world including in Ecuador—also secretly recorded a conversation in which Pólit discussed a bribe that "the Chinese" had paid to Ecuador's former vice president Jorge Glas Espinel.

The lack of safeguard mechanisms in loans from China also undermine the rule of law and efforts to improve governance. The Villonaco Wind Power Project is an example. In 2011, the CDB provided a $37.5 million loan for the project, which was contracted to China's Goldwind Science & Technology Co. Work on the project began on August 24, 2011 and was completed on January 2, 2013. Ecuador's Environmental Regulation for Electrical Activities requires the National Electricity Council to approve a project's final environmental impact assessment and a proposed environmental management plan as prerequisites to signing concession contracts. However, the Ecuadorean government approved the agreement without taking these steps. Part of the agreed-upon location for the plant overlaps with the protected Hoya de Loja Occidental forest. The only environmental impact study used in the project was a preliminary environmental and social impact study from 2003, seven years prior to the start of construction. In 2003, the project site and logistics of wind turbines had yet to be determined, making this report insufficient to assess the specific environmental impacts of the Villonaco project.

KEY TAKEAWAYS

Ecuador's experience should serve as a cautionary tale for other countries seeking to deepen their economic relationship with China. While engagement with Beijing offers many benefits, including access to the world's largest consumer market and finance for projects that other lenders shy away from, the lack of guardrails and unfavorable loan terms can impose a steep hidden cost on borrowers. Governments must be clear-eyed about the risks when accepting finance from China and stand firmly against loan terms that could undermine the rule of law or undercut future growth potential.

Ecuador's oil-for-loans deals illustrate that although partnering with China can be a convenient way for mineral- and oil-rich countries to develop the necessary extractive infrastructure, doing so can have significant implications for a country's development trajectory. Resource extraction alone is not sufficient to secure a pathway to long-term economic growth and often results in significant harm to the environment and local communities. Consequently, a state seeking deals to extract and sell resources to a foreign creditor should aim to use the revenue from its deals to invest in growing other industries where it might be able to attain a comparative advantage, creating an economy that is diversified and resilient to negative shocks. Moreover, any sale of resources from these loans should take place at prevailing market rates to ensure creditors cannot exploit the difference in prices to profit at the borrower's expense.

Allegations of widespread corruption associated with the Coca Codo Sinclair dam and other infrastructure projects illustrate the necessity of establishing procurement policies that are transparent, open, and competitive. Officials as senior as the vice president are alleged to have accepted bribes. Preventing such abuses of power—and exposing them when they do occur—requires that civil society actors and everyday citizens have access to information about key aspects of a project including loan terms. Increased transparency would also strengthen mechanisms for civic participation in government decisions. To that end, legislatures should play an active role in public debt management, including requiring the executive to develop debt management plans and disclose debt-related information, such as debt levels and loan terms, for public consumption. Government agencies overseeing infrastructure projects should adopt democratic channels for participation, consultations, and institutional arrangements to empower the public to shape the development of public works projects and express concerns about projects they deem wasteful or harmful to their environment or community.

The failings of the Villonaco Wind Power Plant further demonstrate how unaccountable loans can facilitate corrupt governments' efforts to undercut the rule of law. Ecuador had legal measures in place that required environmental impact reports; however, these were ignored by Ecuadorean government officials, the China Development Bank, and the contractor involved. The project proceeded because Ecuador lacked the necessary safeguards to prevent such violations of the law. Checks and balances on government power, alongside rules that are fair and transparent, are important to minimizing the risk of harmful effects on recipient countries' democracies and economies that accompany corrosive capital ventures like the Villonaco Wind Power Plant project. Ecuador illustrates the decline in good governance that can occur without due caution, and other countries can learn from Ecuador's experience to protect their own citizens, democracies, and economies.

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For more information on CIPE's corrosive and constructive capital initiatives in Latin America and Caribbean, click here to read *Investing in Latin American Democracy: Impact of Corrosive and Constructive Capital*. This report summarizes the key findings from five years of investigation into the influx and effects of "corrosive" and "constructive" capital in Argentina, Bolivia, Chile, Ecuador, and Venezuela.