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OIL NATIONALISM IN ECUADOR, 1976-1983

Introduction

Since 1974 foreign participation in Ecuador's oil industry has been minimal, with exploration left almost entirely in the hands of Cepe, the young and inexperienced state oil company. Although a large number of companies, attracted by the 'fabulous concessions' then on offer, had entered Ecuador in the 1960s, most decided to leave after the seizure of power in 1972 by a radical faction of the military. With the start-up of production from the country's new fields in the Oriente coinciding with the rise in world oil prices, the new régime of General Rodríguez Lara, anxious to reap the full benefits of the impending bonanza in oil earnings, had moved quickly to implement major reforms to Ecuador's oil regulations. Following implementation of the 1971 Hydrocarbons Law, which enabled the state to take back nearly 70% of the 6.5m ha — almost the entire area of the Oriente basin — then held by foreign companies, the government ordered companies to renegotiate their contracts. Most responded by pulling out. The only remaining operator of any significance, Texaco-Gulf, was compelled to return most of its acreage, pay higher taxes and sell 25% of the consortium to Cepe.

In the years following the collapse of the Lara régime — a brief summary of which is given on page 2 — successive governments, concerned at the rapid depletion in reserves, sought to break with the nationalist policies of the early 1970s in the hope of attracting the large-scale investment needed to revitalise the oil-based economy and the country's flagging oil industry. In fact it was not until 1982, when revisions were made to the Oil Law, that Ecuador's nationalist exploration policy was reversed and finally laid to rest. Throughout the previous six years the ability of first the conservative military junta and then the Roldós and Hurtado administrations to implement a bold, long-term oil strategy was continually hampered by many diverse factors, ranging from their own political weakness and constant wrangling with Congress to policy differences between the Oil Ministry and Cepe. These delays proved damaging not only to the economy but also to Ecuador's attempts to convince potential investors that it was no longer a 'difficult' country to deal with.

The purpose of this paper is to identify the key factors underlying the change in the direction of Ecuador's oil policy after 1976 and then to focus on the failure of successive governments to devise new oil regulations sufficiently attractive to persuade foreign oil companies to return.

The Collapse of the Lara Régime: A Summary

Cracks in the government's nationalist oil policy first began to appear in 1974 when world oil demand and prices fell. Against the background of a growing world oil glut, the bargaining relationship between the Ecuadorian authorities and Texaco-Gulf, which produced over 95% of the country's oil, shifted decisively in favour of the latter:

> If the Ecuadorian government could not market its oil, nationalisation was an empty threat. If the companies did not need Ecuador's oil supply, they could afford to threaten to pull out, while adding to the pressure by cutting back production.[1]

In response to these pressures the government dismissed the radical Oil Minister Captain Gustavo Jarrín Ampudia in October 1974 and dropped his plans for a 51% state share in Texaco-Gulf. After Jarrín's dismissal the consortium initiated an export and investment boycott to force the government to reduce its tax burden and to make oil sales to the internal market more profitable by increasing domestic oil prices.

The slump in oil revenue that resulted — in the first six months of 1975 oil exports were down to $213m (from $430m during the same period in 1974) — led to a mounting budget deficit, a growing balance of payments deficit and an upsurge in popular unrest. In an attempt to alleviate the growing economic and political crisis and yet at the same time avoid 'selling out' to the consortium, President Rodríguez Lara tried to secure a large OPEC loan at the Algiers Conference. Once it became clear that this attempt had failed, the government had no choice but to find a domestic solution to the collapse in oil exports. The head of Cepe, Colonel René Vargas, argued in April that nationalisation was the only solution, but this was rejected by Oil Minister Luis Salazar, who claimed that Cepe lacked both the capital and the technology to take over the consortium's operations. With the OPEC loan unforthcoming and nationalisation ruled out for the moment, the government eventually decided in July 1975 to cut the tax on the export of crude from 58.58% to 53.04%, thereby reducing the cost per barrel by 43 c from $10.84 to $10.41. By taking this action the authorities hoped that Ecuador's oil would become more competitive in the world market and that Texaco-Gulf would end its investment and export boycott and increase the level of production from 165,000 b/d to 210,000 b/d. In the event oil exports were normalised, but the investment boycott was to remain in force until further tax and cost reductions were forthcoming.

As the government braced itself for another company offensive, opposition to the government intensified. In September there was a coup attempt by right-wing officers which, although unsuccessful, highlighted Lara's increasing inability to maintain institutional unity. In an effort to strengthen its position, the government initially eschewed repression, preferring instead to offer concessions to the (largely conservative) opposition forces. The government's actions, however, were interpreted as a sign, not of goodwill, but of weakness, and so the opposition — ably supported by the reactionary media — stepped up their attacks on the régime. Eventually, against the background of strikes and political unrest, Lara was ordered to resign by the three service chiefs on 10 January 1976 and was replaced by a new military junta headed by Admiral Poveda.

The Defeat of the Oil Nationalists

The coup signalled the start of a major change in the direction of the country's oil policies, with the new junta anxious to break with the nationalist policies of its predecessor and move oil policy in a more neo-liberal direction. Two of the key factors in this process have been the political structure and the economy.

The growing political ascendancy of conservative groups and the corresponding decline in the fortunes of the military radicals was reflected in the composition of the junta, with all three members of the Supreme Council of Government, Admiral Poveda, General Luis Leora and General Durán — who emerged as the 'pivotal' figure in the government — on the right of the political spectrum, though Durán initially sought to create a 'progressive' image for himself. Frequent Cabinet reshuffles throughout the year further strengthened the conservative orientation of the government, particularly at the end of 1976 when economic policy was placed in the hands of Santiago Sevilla, a member of the right-wing 'Unión Republicana Democrática' and admirer of the Pinochet régime who was also, along with the future Oil Minister General Semblantes, an habitué

> of the Sunday morning 'polo club' at Quito's exclusive La Carolina racecourse...and...closely linked with...business groups, and particularly with press magnate Antonio Granda Centeno....[2]

Despite the clear shift to the right that the coup represented, the continued influence of the nationalist faction within the armed forces compelled the junta to bring into the Cabinet a number of military radicals, including Colonel Oliveiro Vasconez, who was appointed Minister of Agriculture, and Colonel Richelieu Levoyer, who replaced the conservative General Rubén Davio Ayala at the Ministry of Interior. The most significant appointment was that of Colonel Vargas, the former Cepe manager, whose nationalist approach to oil mirrored that of his close friend Gustavo Jarrín.

At the time of his appointment to the Ministry of Natural Resources, Texaco-Gulf had begun to increase pressure on the government to grant further tax reductions. As a condition for remaining in Ecuador and resuming investment, the consortium demanded a 50 c reduction on the state take for each barrel exported and a further reduction of 55 c before the company resumed investment in the exploration sector. Company executives sought to justify these demands by arguing that, at $10.81, Ecuador's crude was uncompetitive in the US market, though this was a questionable claim since Cepe had succeeded earlier in the year in selling 1m barrels of crude from its 25% share of production to an American company, Phillips Bros. Pan-American, at $11.60 pb. Vargas responded to these demands by publishing in March 1976 his own plans for the country's oil industry in *Petróleo: desarrollo y seguridad*. He dismissed the consortium's request for a $1.05 tax reduction as absurd, claiming that government acceptance of this demand would be tantamount to subsidising the companies to the tune of $51.7m a year. Vargas then argued that, since the companies had failed either to make the investment necessary to maintain existing production levels or to invest in exploration work, steps should immediately be taken to nationalise the consortium, with compensation being paid over a ten-year period at the book value price of $244m. In the meantime Cepe's role in the oil industry should be rapidly expanded.

The government itself found the idea of nationalisation distasteful but because of the delicate balance of forces within the military it could not afford, at this stage, to alienate the nationalist faction and therefore preferred to stay aloof from the ensuing controversy. Not surprisingly, Vargas's article aroused fury amongst not only the oil companies but also the media which continually derided his proposals, arguing — with some truth — that Cepe was inefficient and lacked the technical and organisational capacity to assume total control of the industry. In this respect a report issued in May 1976 by the Instituto Ecuatoriano de Normalización, which sets the technical standards for industry, proved extremely embarrassing to oil nationalists, since its claim that the valves used by Cepe were unsafe came just two weeks before the state company was scheduled to take over the internal distribution of all oil derivatives. The anti-Cepe campaign was not confined to the media, with bomb attacks in August on Cepe's headquarters in Quito and at the offices of a French firm, Boygess-Offshore, which was then holding negotiations with Cepe.

The position of the radicals within the government, meanwhile, was being steadily undermined. A major blow to the nationalist cause came in June when Colonel Levoyer, a close ally of Vargas, was 'transferred' to a military attaché post in Washington. His removal was greeted with ill-concealed delight by the oil companies and their media allies, since Levoyer had earlier published documents purporting to prove that, to finance the media campaign against Cepe,

> $280,000 had been given by Texaco to the deputy editor of the Guayaquil newspaper *Expreso* who had the job of distributing the money among other publications and political organisations.[3]

Although Vargas himself was becoming isolated, the junta was not yet sufficiently secure politically to remove him. With little political support in the country as a whole and with 'a group of progressive army colonels...making its influence felt in the political arena',[4] any sharp rupture with its predecessor's nationalist oil policies had to be ruled out by the junta. With his position secure for the moment, Vargas pressed on quickly with his radical policies, and on 6 June Cepe completed its much publicised (and criticised) takeover of the internal distribution of petrol, motor fuel, kerosene, diesel oil and marine oil. Not unexpectedly, a spate of pipeline 'breakages' — these had an uncanny habit of occurring at the most inopportune moments for the government — swiftly followed, causing oil production to fall sharply. The resulting petrol shortage was further aggravated when an oil tanker — 'quite deliberately', according to the authorities — rammed a pier at Guayaquil harbour.

The most important event during this period was Gulf Oil's decision to leave Ecuador. It had been known for some time that the company was unhappy with its operations in Ecuador, claiming that the government had prevented it from earning a reasonable return on its invested capital — a mere 5% compared with the 15-20% it would have liked —

> by withholding taxes with regard to increased production costs; by failing to pay in full for Cepe's 25% stake; [and] by enforcing the delivery of oil for internal consumption at an uneconomic price.[5]

Once it became clear that the government would not accede to the consortium's demand for a $1.05 tax reduction, Gulf actively sought its own nationalisation, presumably in the belief that a well-compensated withdrawal was the best way of recovering its investment. Although, after months of negotiations, an agreement was signed on 22 April 1977 which allowed Cepe to take possession of Gulf's 37.5% share of the consortium, differences remained over the value of Gulf's investments, but rather than sour what had otherwise been an amicable settlement both parties agreed to appoint an independent auditor — Deloittes — and abide by its valuation. To back up their good intentions both endorsed standby letters of credit to cover the disputed amount, totalling $40m. This long-running dispute was eventually settled in May 1979 with Deloittes placing a $33m price tag on the balance of Gulf's holdings, bringing the total settlement to $115m, which was only slightly lower than Gulf's original estimate. No doubt aware that oil companies outside Ecuador had been waiting to see how Gulf fared in this dispute, the government honoured the agreement and immediately paid Gulf in full.

It should be said that the government had no enthusiasm for the nationalisation, which had been forced upon it by Gulf, and was anxious that the issue should not be 'politicised' to the advantage of the Left and transformed into a nation-wide call for the nationalisation of the remaining oil companies in Ecuador. For this reason the government banned a proposed 'march for the nationalisation of oil' in August and excluded Vargas from the negotiations over compensation terms. While the Oil Minister's demand that compensation be paid in 5-10 year bonds would clearly have found little favour with either Gulf or the government, his exclusion was nevertheless a measure of the extent to which the conservatives had consolidated their influence within the government and the armed forces. Vargas' political fate was eventually sealed when Durán, who had previously been in favour of a nationalist oil policy, openly called for his removal from office in the hope of ingratiating himself with the country's economic élites whilst simultaneously eliminating a potentially dangerous political rival. On 8 February 1977 the government appointed the right-wing chairman of the joint chiefs of staff, General Jaime Semblantes Polanco, to the Ministry of Natural Resources and announced that Vargas was returning to military duties. While Vargas made his way to Chile to assume the position of military attaché, the nationalist manager of Cepe, Colonel Luis Piñeiros, was also 'dismissed' and appointed military attaché to Bolivia.

There is no doubt, then, that these dismissals occurred for political reasons and were designed to facilitate a shift towards a neo-liberal approach to oil policy. Indeed, the removal of Vargas on the same day as an official statement concerning the arrest of Cepe's marketing director Ramiro Estrella on bribery charges was timed to cause the maximum damage to his prestige and to the credibility of the nationalist, progressive line he represented in the armed forces. The military radicals were now, for all intents and purposes, a spent force.

It had already become clear when negotiations began with Gulf in 1976 that a major restructuring of the country's oil policy was being planned. Although it eventually took two years to resolve the disagreement over compensation terms, the government had initially tried to get swift and full compensation for Gulf. This was due as much to Sevilla's fear that refusal to meet Gulf's demands could undermine his whole economic strategy, the success of which was largely dependent on the goodwill of foreign banking institutions, as it was to the government's desire to reingratiate itself with foreign oil companies. Texaco-Gulf's export boycott and the economic dislocation that followed had been sufficient in itself to convince the junta that extreme nationalism did not pay and that a more conservative oil policy was needed to maintain the level of exports and the flow of oil revenue. But the events of 1974-75 only partly explain the shift in the direction of the country's oil policy. Of more significance was the emergence of a number of disturbing developments within the country's oil industry which, since no new major alternative sources of income emerged, had potentially catastrophic consequences for both the economy and the political structure.

The Oil Crisis, 1976-1979

Since the price rises of 1972-73 oil has become the life blood of the economy. From representing just 8% of total export revenue in 1970-72 its share of exports in the following five years averaged 48.5%, with oil receipts averaging $457.2m a year. One survey estimated that during this period oil production generated 61bn sucres, 45bn of which went to the state. As a result of this massive influx of revenue, the economy grew in 1972-77 at an average annual rate of 11.4%, local industry expanded rapidly and income per capita jumped from $597.3 to $1504 in 1982. The end of the oil boom, following the change in world market conditions and Texaco-Gulf's export and investment boycott, served not only to undermine the Lara régime, but to highlight how sensitive the economy had become to fluctuations in oil export levels.

There was particular concern at the downward trend in crude export volumes and the resulting loss of huge quantities of potential revenue. After peaking at 195,100 b/d in 1973, export volume declined steadily, to 122,600 b/d in 1979. In percentage terms this represented a drop of 36.2% in the proportion of oil production exported, from 93.4% to just 57.2%. Part of the reason for this disturbing trend was the stagnant level of production. Although, for conservation reasons, the ceiling on production levels had been set at 210,000 b/d in May 1974, actual production, though reaching 208,820 b/d (76.2m) in 1973, never approached this level until 1979 when new production from City Investings fields helped raise it to 214,200 b/d (78.2m). In the intervening period production slumped to 160,960 b/d (58.7m) in 1975 following Texaco-Gulf's dispute with the government, but then recovered gradually, reaching 201,800 b/d (73.6m) in 1978.

A more significant reason for the drop in crude export volume was the rapid growth in domestic oil consumption, which rose from 32,200 b/d in 1974 to 67,100 b/d — almost 30% of total production — in 1979.[6] The rapid growth in consumption — by about 15% pa during this period — was due to the expansion of the economy in general and the explosive growth of the automobile fleet in particular. Around 60% of domestic oil and derivatives was consumed by the transport sector which had seen a 70% increase in the number of vehicles registered in 1975-79. A further 29% of final energy consumption was smuggled into Peru and Colombia, where domestic oil prices were higher, or simply wasted. While Ecuador's domestic oil prices remained among the lowest in the world, there seemed little likelihood that the country's soaring rate of consumption could be brought under control. Since 1940 the price of the lowest grade gasoline (63 octane) had been pegged at 4 sucres (15 c) per gallon, while the price of higher grade (78 octane) was fixed in 1959 at 4.65 sucres (18 c). To halt the rising rate of consumption and thereby check the steady decline in the exportable surplus the introduction of more realistic prices was clearly essential. Major price increases would not only eliminate smuggling and the irrational use of oil but they would also encourage the substitution of new energy sources by eliminating the artificial edge enjoyed by oil and oil-related products and, with increased investment in alternative sources of energy, help redress the balance between the distribution of energy resources (hydrosources accounted for 78% of total resources, oil only 19%) and the structure of consumption (oil produced 54% of Ecuador's needs, hydroelectricity only 4%). It will later be shown that a more realistic pricing policy would also generate the internal savings needed to allow Cepe to carry out future exploration work. Governments have regarded the reversal of the country's low pricing policy as essential but the political pressures against this have been overwhelming. In this respect Ecuador is no different from the rest of Latin America, where gasoline prices in particular

> are a major focal point for political unrest. Price increases involve opposition from a powerful urban lobby of professional drivers, car users and bus passengers which contains just enough poor people to convey a populist appeal...[7]

In the longer term, the future health of the country's oil industry and, by extension, the economy depended on the implementation of measures to stop the rapid depletion in reserves. As early as May 1975, Oil Minister Admiral Salazar was warning that, unless there were significant additions to the country's estimated 1.5bn bls of reserves, the present levels of output could continue only until 1981. Although estimates on the size of Ecuador's reserves (both actual and projected) differ, the steady downward trend shown in Table 2 is corroborated by the fall-off in exploration drilling in 1973-78, when only 27 wildcats were completed compared with 98 during the boom period of exploration in 1967-72. Unless exploration were stepped up and new discoveries made, and until the soaring rate of consumption could be brought under control, Ecuador faced the humiliating prospect of becoming the first oil importing member of OPEC. A report in *The Times*, which placed Ecuador's reserves in 1977 at 1.3bn bls, warned that

> consumption is rising sharply at an estimated rate of at least 14% annually. This means that unless additional petroleum resources are developed there will be sufficient reserves for only six years within a decade, requiring a drastic reduction in crude oil exports.[8]

Ecuador's real problems, however, were not of '16 years' hence but rather of immediate liftings and the continued flow of oil revenue to maintain economic growth. During the junta's period of rule there were already signs that the economy was moving into recession, with growing deficits in the current and balance of payments accounts, a mounting budget deficit and GDP falling to 6.4% in 1977, and then to 5.8% in 1979. That the economy was not in worse shape was due entirely to the highly favourable terms of trade for the country's traditional exports which in 1978 represented nearly 64% of total export revenue, an increase of 15 percentage points over 1976. One particularly disturbing aspect of the country's economic situation was the growth in external indebtedness. When oil production and exports began falling, and with no significant price increases in 1974-79, the military had tried to maintain oil boom conditions by turning to foreign banks, all of which were willing to supply an OPEC member with loans. Although the military was able to maintain reasonably high growth rates, the jump in the country's debt burden from $241.5m in 1970 to $2.3bn in 1979 left the government with little room for manoeuvre save in the direction of austerity.

The government, though agreed on the need to reverse the downward trend in the economy, was divided on the extent of the crisis facing the oil sector. A number of ministers were certainly pessimistic over the country's future as an oil exporter, with some even questioning whether Ecuador had any oil future to look forward to. In a speech delivered in 1978 Finance Minister Juan Reyna predicted that, with the share of oil in total government revenue steadily shrinking, the state would soon have to rely on more traditional sources of income and foreign exchange, such as taxes and agricultural exports. The 'oil boom', he announced emphatically, was over:

> Ecuador has been evicted from the Garden of Eden. It is time to live in reality; to think of the future of Ecuador on the basis of traditional economic resources and to stop depending on oil; and to work more and pay more taxes.[9]

These calls to 'do away' with the oil mentality that had permeated the country since 1972 were echoed by the General Manager of Banco Central, Dr. Rodrigo Espinosa, who argued that, with oil reserves dwindling and production stagnant, the main impetus for economic growth would soon come exclusively from the agricultural and industrial sectors. Such gloomy predictions were not shared by the new Oil Minister, Jaime Semblantes, or by Texaco, whose manager for operations with Cepe, René Bucaram, publicly claimed that

> the oil boom is not over; it has not even started. There are many possibilities in the Oriente and the coast which ought to be explored, and that, in the worst of lucks, we shall triple reserves![10]

Both views contained an element of truth. Although reserves were indeed dwindling and not being substituted by discoveries in circumstances where domestic consumption was running out of control, oil prospects in Ecuador were undoubtedly good. Past performances alone suggested that significant amounts of oil could be found. During the peak period of exploration activity in 1967-72 almost 70% of exploratory wells proved successful, compared with just 20% in Venezuela, while in the USA a mere 2% of wells were found to contain more than 1 million barrels. Nor was Ecuador's problem a lack of drillable prospects since only a small part of the Oriente basin had been proved by drilling. In fact, the central problem confronting the junta was that, since very little exploration development or maintenance work had taken place following the departure of foreign oil companies and Texaco-Gulf's investment boycott in 1972, Ecuador's tiny proven deposit base was being steadily reduced by production without replenishment by new discoveries. In these circumstances the junta's first priority was to re-establish an amicable relationship with Texaco that would lead to the company dropping its investment boycott.

The Agreement with Texaco

Unlike Gulf, Texaco had remained in Ecuador in the belief that, as a result of the political complexion of the new junta and the prevailing domestic and international oil situation, the major concessions it required for its investment boycott to be lifted would eventually be forthcoming. Texaco was not to be disappointed. In December the company signed a new agreement which committed Cepe and Texaco to investing $20.3m and $11.7m respectively in a programme which was to include geological surveys as well as the drilling of ten exploration wells (mostly in the Shushufindi field) and nine development wells, six of which were to be drilled in the Atacapi and Parahuacu fields. Three other structures — Eno, Vista and Ron — were also to be drilled and maintenance work, so badly neglected by Texaco since 1974, was to be carried out to increase output from the Auca, Sacha and Lago Agrio fields. Oil Ministry officials estimated that the agreement would increase reserves by 100m barrels and, through the additions of new fields and the uplifting of previously known ones, raise output to around 235,000 b/d.

In the following year both parties agreed in principle to establish a new company, Petroamazonas, to help improve the administration of existing jungle fields and increase output and reserves by reconditioning deteriorating oil wells and drilling at precretacic levels. Secondary recovery work was also to be carried out on the major oil fields, particularly the Shushufindi field which contained an estimated 372m additional barrels of crude. Although it was hoped that the new company would begin operations in 1979 this plan, along with the December agreement itself, fell victim to oil politics.

The end of Texaco's investment boycott proved costly for Ecuador. *Decree 285*, which had entitled Cepe to receive 25% of authorised production — set at 210,000 b/d — and not 25% of actual production, was rescinded and made retroactive. This cost Cepe $230m since actual production only averaged 177,500 b/d, way below the level of authorised production. *Decree 287*, which had established limits on the length of time that companies could hold on to (1) concession areas without carrying out exploration work and (2) discovered structures without developing them, was rendered harmless. By the end of April 1976, the deadline for the decree's application, all areas under the control of Texaco-Gulf except the five structures under exploitation were to revert to the state. At Texaco's request it was decided that these areas would only revert to the state if the deadlines for the new annual work schedules were not respected.

A further decision favourable to the American company was the introduction of a more flexible market-oriented pricing policy on exports. Before the agreement Cepe had been trying to sell its share of Oriente crude at state-set prices, which were increased from $12.75 to $13.90 in February 1977 in line with Ecuador's fellow OPEC members who had opted for a 10% increase at Doha in December 1976. Texaco, despite constant pressure from the government, refused to fall into line and continued to sell its share of crude at $10.80. Although some observers have suggested that the break with the state-set pricing system was a *quid pro quo* for Texaco's acceptance of the investment programme, it seems more likely that the abandonment of what had been an almost doctrinaire adherence to unrealistically high prices took place as a result of the serious marketing difficulties Ecuador was experiencing once cheaper Alaskan and North Sea oil began flowing into the US market. With exports falling from 140,000 b/d in June to 70,000 b/d in October the government had no choice but to abandon the official OPEC-oriented price and let it be set by supply and demand.

Although this decision was mutually beneficial, it is less clear who benefited from the changes to the taxation system. The December agreement stipulated that the state's share from Texaco's sales would be based in future on Cepe's sales price, which at that time was fixed at $12.97 pb. Based on this price — which was to be readjusted quarterly — the royalty to be levied was increased on 16 December 1977 from 17% to 18.57% while income tax rose by 15.89%, from 71.42% to 87.31%. Although Sevilla claimed this increased the government's share by 90 c, from $10.70 to $11.60 pb, the former Oil Minister, Rear Admiral (rtd) Gustavo Jarrín, argued that the agreement

> set taxes at an even lower rate than what was acceptable to Texaco, having a net effect of transferring $13m in unrealised taxes to Texaco.[11]

Texaco's profits in 1977 were $1.35 pb, said Jarrín; only $0.95 pb, said Sevilla. The company itself considered the tax and royalty increases to be 'substantial', but nevertheless still felt that the new terms provided it with a reasonable return on investment.

Hostile reaction to the agreement was confined to a small but significant group of hard-line nationalists headed by Jarrín, who described it as 'the biggest Christmas present in the country's history' and advocated a return to a policy of full nationalisation and to posted prices that would reflect the OPEC rises of recent years.[12] Most Ecuadorians opposed this line and even many nationalists, recognising the critical oil situation and Cepe's inability to carry out the necessary exploration and exploitation work on its own, accepted that the company's continued participation in Ecuador was, regrettably, essential. However, the absence of any concerted opposition to the agreement was no indication of the possible response that might accompany moves to secure the return of foreign oil companies to Ecuador. Renegotiating a contract with a company which had been operating in the country since 1967 was far less politically sensitive and risky than tampering with the 1971 Oil Law and offering more favourable terms to investors. Nevertheless, the junta initially appeared willing to risk the possible political dangers that could accompany the shift towards a more neo-liberal oil policy. Soon after becoming Oil Minister, Semblantes announced that, since Cepe 'is no longer able to undertake all the exploration required', steps were under way to grant 'attractive incentives' to potential oil investors.[13] Few details were available at the time but it was generally assumed that the 'incentives' involved major revisions to the 1971 Oil Law.

Cepe: an Alternative to Foreign Investment?

The adoption of a more neo-liberal approach to oil policy was also occurring in other producing countries of the Third World which, like Ecuador, were becoming primarily concerned not with ownership but with the need to halt the rapid depletion of their reserves. Faced with the realisation that their own state oil companies lacked the financial and organisational capability to accomplish this task, a growing number of governments came to accept the near indispensability of private oil companies with their large capital resources, skilled management and sophisticated technical expertise. As a result, previous nationalist policies were reversed and oil policy swung in a direction favourable to foreign investment: in Latin America itself investment was invited back on a scale unknown since the 1920s.

While conservatives and their media allies in Ecuador had undoubtedly been too ready in their campaign against the Lara régime's oil policies to criticise their own state company, the claim that Cepe was not a viable alternative to foreign oil companies was largely valid. Although Cepe had begun undertaking its own exploration work in 1977, its financial debility, together with its lack of national technicians and managerial resources, made it impossible for the company to mount an extensive exploration programme. In response to nationalist pressure its scope of operations had been rapidly expanded, thereby stretching already limited resources and leading Cepe into areas for which it was ill-equipped. The period after Cepe's takeover of the internal distribution of oil derivatives in June 1976, for instance, was plagued by a series of petrol shortages. As a result of further shortages in September 1977, the company's technical director Guillermo Bixby was forced to resign.

Cepe's rapid expansion led not only to severe organisational and technical problems but to mounting concern among conservatives and the private sector at the growing role of the state in the economy and the increasing share of oil revenue diverted to Cepe. In these circumstances measures designed to reduce Cepe's scope of operations were to be expected, given the political complexion of the new government and the subsequent demise of the military radicals. The new Oil Minister had reasons of his own for clipping Cepe's wings. If a sharp break with the nationalist policies of his predecessor was to be enacted, then steps to reduce Cepe's extensive influence in the oil industry were essential

> lest its power grow so large as to become unwieldy, preventing future governments from pursuing their own oil policies.[14]

For organisational and political reasons, therefore, the government decided at the end of 1977 to remove from Cepe responsibility for domestic sales, transportation and marketing, and announced that its participation in petrochemicals and other petroleum-related operations was no longer mandatory.

The most pressing and seemingly insuperable factor inhibiting Cepe's ability to carry out an effective exploration programme was its lack of funds. As early as 1976, the head of Cepe was expressing concern over the company's ability to meet operational costs and keep up to date the payment of some projects under construction, let alone invest in exploration and development work, research and other activities essential to ensure Ecuador's future as an oil exporter. In these circumstances the junta's decision, in response to conservative pressure, to reduce Cepe's share of the budget to 23.66% in July 1977 by subjecting its income to a 17% royalty, dealt a severe blow to the company's already precarious financial position. It was estimated that the 8.5% of this royalty earmarked for the military alone would cut the company's income by $600m in 1979 and $1.13bn in 1980.

A further blow to Cepe's finances came at the end of 1979 when, despite opposition from the company's management, its share of oil revenue was reduced from 24% to just 7% of external crude oil and derivative sales. Cepe's ability to finance capital projects was further restricted in 1980 by the government's decision to maintain the oil price used as the base for computing the company's share of oil revenue at $23.50 pb, even though world prices at the time were well over $30. The financially debilitating impact of these measures — one Cepe manager warned that the company faced a real possibility of going bankrupt —

highlights how vulnerable a company which cannot count on internally-generated funds for self-sufficiency is to political pressure. Cepe's own vulnerability was a direct consequence of the tight governmental controls on the price of oil products sold to domestic consumers. With oil sold on the local market for a small fraction of world prices, Cepe was unable to generate internally sufficient funds for investment in exploration and exploitation out of its sales. Official sources estimated that if the heavily subsidised oil products had been sold at cost* the price of 78 octane gasoline would have been 8.36 sucres per gallon in 1979 and 13.12 sucres in 1980, while a report by the Oil Ministry predicted that the oil derivative subsidy for the domestic market would be $525m in 1979, an increase of $225m over 1978. With income low and financial commitments high, therefore, Cepe had few capital resources left for exploration and development work. Even then it appears that much of Cepe's remaining finance was used inefficiently and wasted on 'political wells', that is, the drilling of 'wildcats' in fields discovered by foreign oil companies before 1972 and the subsequent claim by Cepe that it had proven 'successful' in its exploration work. These fields are often small, of heavy crude and located far from the principal production centres. A leading oil expert in Ecuador, Julio César Granja, went so far as to claim that

> 90% of oil exploitation since 1973 has been carried out by Cepe at high cost, with negative economic consequences under a technical-economic balance sheet but positive results if the balance sheet takes into account the political publicity.[15].

For the junta, the civilian administrations that followed and, increasingly, many 'nationalists', the country's deteriorating oil situation coupled with Cepe's financial debility and lack of managerial and technical expertise made the participation of the private oil companies essential to revitalise both the oil sector and the economy as a whole. There was a growing realisation that foreign oil companies were better equipped to tackle the task of discovering substantial quantities of oil than financially weak state oil companies like Cepe owing to the nature of oil exploration itself. Not only is oil costly to find and develop, particularly in Ecuador where the most promising areas for the location of oil tend to be either offshore or in remote, heavily forested onshore locations, but it is also extremely risky, with the failure to discover commercial amounts often leading to the loss of vast sums of investment. International oil companies can operate more successfully in this phase of operations as a result not only of their managerial and technical expertise but because, by operating in different parts of the world, failures in some projects can be compensated by successes in others. Despite the optimistic claim by hard-line nationalists that Cepe represented a viable alternative to the private oil companies, the fact remained that

*that is, the weighted average between the cost of the imported gasoline and the cost plus taxes of gasoline produced in Esmeraldas plus distribution charges.

> even if Ecuador had the financial resources to carry out its exploration programme, the risk would be fairly high and costly for the country. That is, it would not be worth taking it on when there is a much more advantageous alternative if we accept the collaboration of risk capital from outside.[16]

The economic *and* political costs that could be involved were graphially illustrated in 1982 in the scandal surrounding Cepe's contract with 'Permago' for offshore drilling in the Gulf of Guayaquil. Over $18m was invested in the first well but no commercial quantities of oil were found. Similar results were obtained from a second and third well, both of which consumed over $30m worth of investment. In the ensuing uproar the contract was rescinded and Oil Minister Eduardo Ortega ousted following a congressional censure vote in September.

It was because major oil companies were more adequately placed than Cepe to carry out an effective exploration programme that the junta sought to persuade these companies to return, supplement the resources of Cepe and make the new discoveries of reserves in quantities sufficient to expand production to meet export and domestic requirements and ensure the country's oil future.

The 1978 Oil Law

In the event the junta's ability to devise 'incentives' sufficiently attractive to secure the return of foreign investment was severely constrained by political considerations. Despite its bold talk, the junta eventually proved unwilling to accept the political and pyschological risks that would inevitably accompany any sharp break with the country's nationalist past. Even after 1976 the populist appeal of oil nationalism continued to be a feature of contemporary Ecuador which no government could easily ignore, particularly one, like the junta, which had no political base of support. The continued influence of oil nationalists within Cepe, the military (especially the navy), labour organisations and the universities made it doubly difficult for the junta to take the necessary steps to restore investor confidence and devise oil regulations that were, at the very least, competitive with those existing in the rest of Latin America. For political reasons, therefore, the administration was compelled to perform a delicate balancing act when drawing up revisions to the 1971 Oil Law. According to *Weekly Analysis*,

> changes in oil policy which were too drastic could lead to attacks on the government from the left and nationalists who felt a sell-out had taken place. It was therefore necessary for Semblantes to preserve the present measure of control over the oil industry and participation in profits which were the plusses of the 'nationalistic' policy followed by his two predecessors.[17]

The Oil Law of 1978 did contain a number of important concessions to oil companies. Although exploration and development work was to be carried out at the investor's expense, the contractor had the right to receive, once 'commercially exploitable hydrocarbons' had been discovered,

> a volume of hydrocarbons enabling him to recover his investment, in adequate terms and with reasonable profit margins.[18]

The hydrocarbons received as payment could not be used to cover domestic needs, though if such oil was required for this purpose it would be purchased by Cepe at international, *not* domestic prices. Companies were exempt from the payment of royalties, surface duties and entrance fees, and were no longer obliged to return equipment, machinery and installations to Cepe at the end of the exploration programme. The size of the area contractors could retain during the exploration period was doubled and the minimum investment required was reduced to one exploratory well per 100,000 ha, and 1000 sucres per hectare in each year in the first three years of the exploitation period.

While these concessions were not inconsiderable, they did not, as Jarrín later claimed, represent a 'sell-out' to the oil companies. Indeed, *World Oil* went so far as to argue that, while the junta and Semblantes may have genuinely desired the return of foreign investment, the law reflected

> a strong feeling within Cepe and in the Oil Ministry that foreign oil companies should be given their walking papers.[19]

Apart from having to invest at least 10% of their net profits in Ecuador, either in their own businesses or those connected with other hydrocarbon activities, companies were required to pay yearly to the state after the start of the exploitation period an amount 'which shall depend on the production of the contract area' to fund energy research and development. Within six months after the start of operations, companies had to ensure that at least 95% of labourers, 90% of administrative staff and 75% of technical staff were native Ecuadorians. A further provision stipulated that a company which had entered into a contract for the exploration and exploitation of crude oil had no rights to any natural gas discovered. Additional contracts for the exploitation of gas could be signed, though only if the contractor had discovered what the law vaguely termed as 'commercially exploitable' fields.

Overall, the practical effect of the new law would have been to *increase* the state's control over the oil industry. Not only would companies dispose of less crude, since they would only be permitted to market the crude given as payment, but they would be unable to boycott crude sales as only Cepe would handle crude. Pressure against increases in the reference price or the level of taxes, so often occasions for conflict in the past, would also no longer be possible since companies would no longer be subject to them. While the revisions as they stood were clearly inadequate, oil investors delayed making any final judgment on the government's invitation to explore for oil until uncertainties surrounding the political complexion of the new civilian government, scheduled to replace the junta in August 1979, were resolved.

The junta undoubtedly took a number of important steps to untie the nationalist knot that had gripped the country's oil industry since 1972. A reconciliation with Texaco had taken place, a more flexible market-oriented pricing policy on exports introduced and the rapid expansion of Cepe checked and reversed. Some concessions were made to the oil companies in the 1978 Oil Law but, for reasons already mentioned, the junta was unable to repudiate totally the nationalist policies of its predecessor and, as will be shown later, consequently failed to restore 'investor confidence' in Ecuador. When viewed from a wider political perspective, it is clear that this inability was the result of the junta's own political weakness and its overriding political priority of transferring power to an elected civilian government by 1979. Both factors combined to produce a régime whose chief concern was with orderly administration and the avoidance of any politically risky policy innovations or initiatives — and this would include a 'sell-out' to the oil companies — which could inflame the political situation and threaten the return to civilian rule. This was graphically illustrated by the junta's response to the rapid growth in domestic oil consumption. Early in 1978 the junta appeared to be preparing the population pyschologically for a major reversal in the country's low price policy, with government ministers continually warning of the dire economic consequences facing Ecuador if the soaring rate of consumption continued. Support for price increases came from the Federation of Gasoline and Diesel Distributors which wanted a higher margin per gallon for its associates, and the Quito Chamber of Commerce, whose president, Carlos Ponce — himself a car distributor — pressed for derivative prices to be increased to 10-12 sucres per gallon. Price rises would also, of course, have found favour with Texaco, which was forced to sell crude to Cepe at domestic prices.

Some indication of the response the government might expect if major price increases were implemented came in April 1978 when transport fares rose by 40%. The ensuing violence left four dead and hundreds injured with order being restored by the army on 11 April after ten days of unrest. In the wake of these disturbances, plans for major oil price increases were shelved, and the junta contented itself with a series of measures designed to halt the rapid growth in vehicle imports which accounted for the vast bulk of the increase in cars in use from 82,000 to 230,000 between 1970 and 1977. Although it was hoped that substantial tariff increases would have the indirect effect of slowing down the growth in gasoline consumption, these measures were a rather poor substitute for a major price increase, particularly since a number of multinationals were already planning to establish car plants within Ecuador.

The Transition to Civilian Rule

Despite the junta's efforts to side-step such politically risky policy initiatives, the transition to civilian rule was not without its problems, particularly after the victory of the centre-left ticket of Roldós and Hurtado in the first electoral round in April 1978. This unexpected result shook the oligarchy and the commercial elites who had assumed, after Assad Bucaram, the country's leading populist, was debarred from standing for the Presidency, that the junta would maintain a tight grip on the electoral process. Faced with the clear prospect of a reformist government being elected in 1979, conservative apprehension towards Jaime Roldós, the CFP's replacement candidate for his uncle Bucaram, and his radical Christian Democrat running mate Osvaldo Hurtado, was transformed into a fear that often bordered on hysteria, with powerful economic groups aided by the media initiating a campaign of psychological terrorism, warning voters of the consequences if the 'dangerous radical' Roldós and 'closet Marxist' Hurtado were elected to power. Despite their claims that the people would be voting in a Marxist dictatorship, it is clear that their real fears centred on Roldós's oft-repeated election promise to end the oligarchy's days of 'backroom clique' politics, halt corruption and tax evasion, and increase the level of taxation on high income groups.

In the growing political tension orchestrated by conservatives, right-wing officers opposed to the return to civilian rule attempted to topple the junta in September 1978. Although the collapse of the coup in its formative stages confirmed that the bulk of the officer corps favoured 'el retorno' (the return process), General Durán's control of the strategically vital Galapagos armoured brigade in Riobamba and the continued existence of other *golpista* officers posed a potential threat to the junta. There was, in addition, still a possibility that in a more unstable political environment officer support for the return to democratic civilian rule could be undermined. With this thought in mind, right-wing elements conspired to raise the political temperature in November 1978 by assassinating the unsuccessful candidate of the Alfarista Party, Abdon Calderón. Subsequent investigations revealed that the murder had been planned by the Minister of Government General Bolívar Jarrín, a close ally of Durán, his aide Major Jaime Hermosa and the national police chief, Colonel Alberto Villamarín Ortíz. Instead of plunging Ecuador into political turmoil, the murder and the ensuing scandal provoked a fierce reaction from all sections of society against those seeking to disrupt the return to civilian rule, and allowed the second — and final — round of elections to take place.

Roldós's overwhelming victory in April 1979 over the centre-right candidate Durán Ballén and the remarkable collapse in support for the country's traditional parties marked a turning point in the history of Ecuador's political development. In place of the elitist cliques and populist caudillos that had dominated the political scene since independence there had now emerged, principally in the form of the CFP, Izquierda Democrática and a number of small left-wing parties, new forms of political organisation led by well-trained and well-educated professionals armed with comprehensive economic and political programmes and supported by large sections of the populace. Economic growth since the 1950s, together with the accompanying spread of literacy, education, rural-urban migration and the emergence of an urban middle and lower class, had undoubtedly helped erode the political dominance of the oligarchy but it was essentially the oil boom that brought an end to the old political order and led to the election of a progressive middle-class President.

The size of Roldós's victory — he won nearly 70% of the votes cast — reflected his success in winning the support of both the newly emerging middle class and the lower classes. Although the oil boom and the accompanying growth in local industry, commerce and bureaucracy had benefited the urban middle classes and accelerated their expansion, they regarded the prevailing political structure as an anachronism which served to maintain the interests of the oligarchy and frustrate the economic and political aspirations of their own, increasingly important, class. According to one observer of the political scene,

> many younger members of the growing middle class — lawyers, academics, progressive capitalists — found the existent political order inadequate to the needs of an expanding, gradually modernising economy. Consequently, [in 1979] they looked for new political alternatives.[20]

Far from regarding Roldós as a Marxist or radical, these groups saw him as representing the most progressive, modernising sector of Ecuador's professional and capitalist class and thus an obvious alternative to the old parties.

Roldós also received overwhelming support from an increasingly politicised lower class which had benefited little from the oil boom. Despite rapid economic expansion and the Lara régime's promise to effect major socio-economic reform, the period 1972-79 witnessed no radical reforms, no restructuring of the agrarian sector, no redistribution of income and no change in the economic and political power structure. Indeed, reports issued by Guayaquil University and Banco Central in 1977 showed that the socio-economic position of the lower classes had actually worsened. Rather than use the oil wealth to finance populist policies and agrarian reform, the military preferred to invest in large development projects such as hydro-electric schemes, oil refineries, infrastructural improvements, pipelines and communications. The remaining revenue was channelled into the armed forces and government bureaucracy or simply squandered. In these circumstances, Roldós's emphasis during the election on current, rather than capital, spending and on the need for a short-term reactivation programme to improve socio-economic conditions was inevitably received enthusiastically by the mass of Ecuadorian people.

With the demise of the old political order and with the state, rather than the oligarchy or commercial elites, now in control of the country's main source of income, Roldós had the opportunity to consolidate his electoral support by using the oil wealth to finance 'welfare politics' and semi-reformist policies. It was therefore likely that the shift away from oil nationalism begun by the junta would be continued if not accelerated under Roldós. While a military government which is not accountable to the electorate can afford to take a long-term view of economic development and concentrate on building an infrastructure for future prosperity, an elected official has to show tangible results in the short-term to win electoral advantage. For democratic governments in oil-exporting countries, therefore, it is essential

> to buy, or at least to maintain political support by judicious public spending policies. Once these come to benefit the majority or even a large minority of the electorate it becomes crucial for any government to keep up the flow of revenue. *Under such circumstances confrontational or overly ambitious oil policies are generally avoided.*[21]

The likelihood that the new government would continue the shift away from the nationalist oil policies of the early 1970s was reinforced by further gloomy forecasts on Ecuador's future as an oil exporter. One report issued by the Junta Nacional de Planificación in late 1979 predicted that the proportion of oil production exported would fall to 37% by 1981 and then to a mere 15% by 1982 unless immediate steps were taken to halt the soaring rate of domestic consumption. In the absence of substantial reserves being discovered, total production would decline steadily to 59m in 1984 and reserves would drop from 1.4bn to 909m bls between 1979-84.

Government Oil Policy: 1979-1981

Not unexpectedly, therefore, the new government issued an early statement on the necessity of opening the country's oil industry to foreign investment, and in December invited tenders for the exploitation of 10m ha. Cepe officials claimed that the $995m project, which included drilling, exploration, production, offshore operations and the construction of refining and petroleum facilities, could increase the country's reserves by as much as 2.16bn bls. Company response to the tenders initially appeared promising, with the *International Herald Tribune* reporting in July 1980 that

> a number of foreign oil executives have been in and out of Quito in the past few months, indicating that the government may be drawing some of them back into exploration.[22]

Such optimistic claims proved to be misplaced. Indeed, in the meetings to which the *Tribune* referred the government was left in no doubt that the 1978 revisions did not go far enough and that unless more substantial incentives were offered, and until investors could be convinced that the sanctity of contracts would be respected, no investment would be forthcoming. In view of the strong competition among developing countries for foreign capital and expertise, and given oil company perceptions that Ecuador was a 'politically difficult' country to deal with, the new government had to recognise that the 1978 oil amendments were wholly inadequate. In the late 1970s Ecuador represented just one of a number of investment opportunities available to oil companies in Latin America where many countries, including Peru, Argentina, Colombia, Brazil and Chile, were anxious to attract risk capital to replenish depleting reserves and were already revising their oil regulations accordingly. There were also numerous opportunities for investment in the North Sea, Alaska and South-East Asia, where geologically promising areas had already been discovered and where, in comparison with Ecuador and much of Latin America, the 'political risk' was seen as minimal. After their experiences during the oil market revolution of the early 1970s, when companies were either nationalised or forced to renegotiate contracts which increased the state's share in profits and severely curtailed the scope of company operations, there was great reluctance to invest in what may loosely be termed 'politically difficult' areas. When evaluating exploration opportunities it was no longer sufficient for a host government or company officials to assure management that a basin had good hydrocarbons potential, that contractual terms were acceptable and that fiscal terms permitted an adequate rate of return. Companies now had to be convinced that the political environment was relatively stable and favourable and, more to the point, that the sanctity of contracts would be respected by the authorities and not be subjected to rapid, unexpected changes. In this respect Ecuador was poorly placed in its attempts to attract investment, with companies continually complaining that successive governments had been

> too haphazard and carefree in settling and enforcing the conditions attaching to their operations in Ecuador.[23]

In fact, evidence of any degree of continuity and consistency in government oil policy since 1976 has been conspicuously absent. Oil companies had, of course, been concerned by events earlier in the 1970s when the Ecuadorian government cancelled most foreign-held concessions, increased taxes and purchased a majority share in Texaco-Gulf. But these measures were — at least in retrospect — largely understandable given the nationalist orientation of the Lara régime and the prevailing world oil market conditions. What puzzled and worried potential investors was that after 1976, when Ecuador was actively seeking by word and, as far as the political situation would allow, deed to attract foreign oil investment, its treatment of companies already operating in the country was at best inconsistent and unreliable, at worst downright antagonistic. Companies were particularly concerned by the long-standing record of discord between successive governments and companies operating in the Gulf of Guayaquil.

Ever since the discovery of the rich Amistad gas fields in 1970-1972, offshore exploration and exploitation work had been dogged by disputes. In November 1972 the ADA concession was cancelled, with the government alleging that irregularities had taken place when the concession was first granted in 1968. ADA responded by suing the government for $25m. When the North-West Oil Company later bid — successfully — for the concession, ADA brought out another suit claiming that the bid resulted from a breach of confidentiality involving a former ADA employee. Although the suit remained dormant, North-West soon found itself embroiled in another conflict, this time with the government, on the utilisation of the gas discovered. The original plan had been for an ammonia-urea plant to be built to process the gas into fertilizer, but the subsequent collapse in the world price of ammonia-urea made the project (at least in North-West's view) unprofitable. With the government remaining firmly committed to using the gas to develop the country's fertilizer industry North-West, claiming that its contract permitted it to cease operations if they became uneconomic, suspended all drilling and exploration work. The dispute continued for two years until, in late 1979, Cepe rescinded the contract, assumed all exploitation and drilling rights and took over the company's drilling equipment, machinery and vehicles. To many outside observers Cepe's behaviour in the two-year dispute merely served to confirm that, despite the neo-liberal rhetoric, Ecuador remained a difficult country to deal with. The weekly publication *Business Latin America*, writing soon after Cepe's decision to rescind the contract, commented that

> the government's handling of the North-West dispute is a discouraging reminder to all companies of the contrariness that can sometimes surface in Ecuadorian policy-making, particularly where natural resources are concerned.[24]

Texaco's own experience in Ecuador after 1976 did little to allay company concern. Amicable relations with the government had apparently been re-established in 1977, but Texaco's failure in the following three years to implement its share of the agreed investment programme highlighted its sense of insecurity and frustration with the conditions in which it was operating. Although Texaco consistently argued that oil production could be increased on the basis of known reserves, some observers were convinced that the company was deliberately avoiding major investments and aiming instead at the rapid depletion of its wells in the belief that its own future in Ecuador was, at best, unclear. According to *Weekly Analysis*,

> Texaco seems to feel that its days in Ecuador are numbered. Perhaps it is because mounting domestic consumption is causing a shrinkage of the amount of oil the company takes for export. There is no profit in oil sold for domestic consumption. Perhaps the company believes that politics will require its complete fade-out in a few years.[25]

Although Texaco finally agreed in 1980 to carry out its share of investment, Dan Archer, the head of the company's operations at Lago Agrio, has since made no attempt to hide his concern with the attitude of the authorities:

> You come in and spend money on exploration and development, and then the government says 'we'll tell you what you get'. [In 1981] the net profit was equal to the revenue from one day's production.[26]

Oil companies placed much of the blame for the ambiguous and often contradictory nature of Ecuador's oil policies on Cepe which, despite having its wings clipped by the junta, continued to exercise a significant degree of influence on the oil policy-making process. One company official recounted how, after receiving an encouraging visit from one Oil Minister, a team had flown to Quito at his request to analyse in detail the possibilities for investment. From the reception that the team received on its arrival it was clear that the company was not welcome. The official was convinced that the Oil Minister had been rebuked by Cepe on his return to Ecuador and told that no further talks should take place.[27] There is certainly no doubt that relations between the government and the Oil Ministry on the one hand and Cepe on the other have been far from cordial, particularly after 1979. The rapid turnover in personnel that resulted — between August 1979 and the end of 1983 there were five Oil Ministers and five Cepe managers — not only harmed Cepe's operational capability but also hindered the government's ability to initiate and implement a long-term oil policy and left companies puzzled as to who in Ecuador was in charge of oil policy.

The tension that surfaced when the junta reduced Cepe's share of budget allocations and its scope of operations became particularly acute during Roldós's period of office, with the principal sources of conflict centring on the role of Cepe, its relationship with the Oil Ministry and the terms on which foreign oil companies were to return to Ecuador. Dr. Mauricio Dávalos, the new Oil Minister and member of the Democratic Party, believed that Cepe should be tied more closely to his own Ministry, that its operations should be confined to refining and marketing, and that exploration and exploitation work should largely be carried out by foreign companies. On the other hand, the new Cepe manager, José Carvajal, in the tradition of previous managers, sought a more ambitious and independent course for the company and adopted a more lukewarm attitude to foreign oil investment, arguing that, with increased budget allocations, Cepe itself could carry out much of the work needed to increase reserves substantially. His announcements (usually premature) of major 'oil finds' by Cepe — the Tena field for instance — appeared to confirm that he did not regard the return of foreign investment with the same urgency as the government. At one stage Carvajal even accused the government of deliberately exaggerating the oil crisis in order to prepare the way for the return of the oil companies.

César Robalino's appointment to the Oil Ministry in place of Corsino Cárdenas, who resigned for unclear reasons six weeks after taking over from Dávalos, brought into sharp focus the conflict between Cepe and the government. Since becoming manager Carvajal had

> strived to invest the manager of Cepe with the prerogatives to conduct wide-ranging oil policy matters. It was he who negotiated with Texaco; it was Cepe who was to deal with the foreign oil companies...it was Cepe who was to have the louder voice in Petroamazonas.[28]

And yet during his term as Cepe manager no contracts were signed and little headway was made towards the creation of Petroamazonas, clear evidence in Robalino's view that Carvajal never intended making progress on either of these matters. In view of this, and as part of a continuing government effort to tie Cepe more closely to the Oil Ministry, Robalino assumed many of the functions previously exercised by Cepe, including the negotiations with Texaco and the drawing up of new risk contracts. In October 1980 Carvajal, bereft of Cabinet support and now out of favour with Roldós, was dismissed and replaced by the President's private secretary Xavier Vidal Mason who, though quick to confirm that overall responsibility for oil policy would lie with the government and not with Cepe, resigned eight months later in protest at the government's decision to reduce production from 228,000 b/d to 217,000 b/d in line with OPEC policy, and was replaced by Jorge Pareja Cucalón.

Carvajal himself was convinced that he had been removed because the government regarded him as an obstacle to its policy of offering easier terms to the oil companies. After his dismissal, Carvajal warned that

> the nationalistic policy he espoused is to be laid aside in favour of another of easier terms for multinationals and more opportunity for local wheeler-dealers.[29]

Even without Carvajal as manager of Cepe, however, progress in the area of oil policy would have been difficult given the government's weak position within Congress. Despite Roldós's overwhelming victory at the polls, his ability to rule was continually hampered by Congress and its president Assad Bucaram who, having formed an alliance with the CFP's ideological enemy the Conservative Party, was determined to settle old scores with his one-time protégé. Although the CFP had planned that Roldós would be a mere 'figurehead' President with real political power being exercised by Bucaram, his independent stance, highlighted by his choice of Hurtado as his running-mate, antagonised his uncle and eventually led to a complete rupture between the two men. Once Roldós had taken office, Bucaram, armed with a working majority, sought to punish his nephew by sending inflationary and economically embarrassing projects for executive decision and by throwing out, delaying or watering down bills submitted by Roldós. In these circumstances, little that required the approval of both the Executive and the Legislature, including the revision of the Oil Law and the creation of Petroamazonas, had much chance of being accomplished.

Following Carvajal's removal, Robalino adopted a more urgent approach to the country's oil problems. In a speech delivered on 13 March 1981 he pointed out that since 1972 exploration had been at a standstill, production had declined and reserves had fallen from 1.5bn bls to 1bn, barely enough at the present production rate of 76m bls a year to cover Ecuador's oil needs for more than 12 years. Since Cepe lacked the resources to boost reserves, Ecuador had no choice but to rely on foreign investment. It was essential, therefore, to offer more attractive incentives to potential investors and to convince companies

> with a proven record to finance and conduct exploration onshore and off...that Ecuador is no longer a difficult country to deal with. What matters to foreign oil companies is net profits and we shall be competitive on that score.[30]

To this end Robalino proposed a number of revisions to the Oil Law. The key amendments provided for a graduated income tax depending on the size of the reserves discovered, ranging from 48% for reserves of up to 100m bls to 89% for reserves of more than 1.5bn bls; a new risk contract with compensation in US dollars for the cost of discovering deposits; and an arrangement giving producers preferential purchasing rights to obtain crude from Cepe at international prices. A spokesman with the Oil Ministry insisted that these revisions would enable companies to earn a rate of return of 20-30%, though this claim was viewed with some scepticism by oil companies. Donald Kiefer, who coordinated negotiations for Mobil's exploration units, was unimpressed. In the third week of April he and representatives of four other companies met with Robalino to discuss the reforms. Clearly disappointed by what he had heard, Kiefer left the meeting claiming that Mobil still needed some 'positive reason' to invest in Ecuador, though he added that the company would 'wait and see what comes out of Parliament' before passing any final judgment.[31]

It was to be a long 'wait'. Following the submission of these proposals to the National Chamber of Representatives on 9 April 1981, it was decided that the 'Comisión Legislativa de lo Económico, Agrario, Industrial y Comercial', headed by Arg. Hugo Caicedo Andino, should invite the country's different political, economic and academic sectors to present their views on the proposals, the country's oil crisis and the need for foreign oil investment. In response to those critical of this decision, the Commission argued that the legal, political and economic implications of the government's proposals were of such importance that discussion of the issue could not, as in the past, be confined to a small clique of government officials and oil experts whose judgments had, more often than not, been viewed with distrust by the people and by the very oil companies the country was now seeking to attract.

That some may have felt a sense of frustration at the decision to carry out a comprehensive survey of national opinions was hardly surprising given the almost continuous delays to which the implementation of energy initiatives had been subjected since 1979. Unable to obtain a stable congressional majority, Roldós found himself under attack during the first twelve months of his rule by the Bucaram-led Congress which constantly sought to undermine his authority by sabotaging, blocking or delaying any economic, political or energy proposals emanating from the Presidential Palace. Although Roldós obtained majority support for the election of Raúl Carbo as Congressional President against Bucaram in August 1980, the vote was so close that he remained, until his death in May 1981, beholden to constantly shifting alliances in a Congress whose primary interest remained focused on political exercises rather than the pressing task of formulating and implementing the necessary measures to revitalise the oil sector and the economy. The situation changed little under the new President, Osvaldo Hurtado, whose ability to rule was similarly constrained by a Congress characterised by rampant opportunism and rapid changes of political allegiance. That Hurtado and not Roldós did eventually prove successful in obtaining Congressional support for reforms to the country's oil regulations was largely due to the different economic and political conditions existing during their periods of office.

The circumstances under which the Roldós government was attempting to implement its energy strategy were hardly likely to help concentrate the minds of Congress and society as a whole on the country's oil crisis and the urgent need to lure foreign companies back to Ecuador. Indeed, it is likely that some officials felt that the change in world oil market conditions would enable Ecuador to adopt a tougher negotiating stance with potential investors. After six years of relatively stagnant oil prices, the country experienced a second oil boom following the Iranian Revolution and the outbreak of the Gulf War. With fears of an oil shortage leading to an undisciplined scramble for supplies, OPEC countries were able to treble their official selling prices in 1979-80. In Ecuador the record crude price of $13.15 pb at the end of 1976 faded into insignificance as prices jumped to around $40 pb. With the start-up of production from City Investings fields raising production by 6% to 78.2m (214,200 b/d), the highest level since 1972, and Cepe's decision to take its 18.5% royalty from Texaco in oil (15,000 b/d) rather than cash, Ecuador was well placed to take full advantage of the price rises. In 1979 crude export earnings jumped by 85% from $558m in 1978 to $1,032m and then increased by a further 35% in the following year to $1,394m, despite a 4.7% fall in production and the proportion of crude output available for export falling to 54%. The bonanza in oil earnings coincided with less sensational increases in traditional exports to leave trade surpluses of $54m and $302m in 1979 and 1980 respectively, compared with a deficit of $175m in 1978. While the oil boom was insufficient to reverse the downward trend in the economy, it did nevertheless enable the government to maintain political peace by pursuing an economic policy characterised by rapid, officially protected industrialisation, high wages for the workers and all manner of incentives for employers.

Government pronouncements on the extent of the country's oil crisis and the urgent need to secure the return of foreign oil companies were therefore viewed by many with some scepticism. The belief that the government might deliberately be 'exaggerating' the crisis, as Carvajal claimed, was further reinforced with the adoption by Cepe and Texaco of a more dynamic and, to a large extent, successful exploration and development programme. At the start of 1981 the *Petroleum Economist* wrote that the preceding 18 months had been

> one of the most productive discovery periods since the existing producing fields were found by Texaco and Gulf in the late 1960s.[32]

Although Texaco's failure to fulfil its part of the 1977 agreement had led to suggestions that the company was planning to close down its operations, it became clear in 1980 that no immediate pull-out was being considered. According to Robalino, the government — its patience exhausted — decided to force Texaco to start secondary recovery work on the Sacha and Shushufindi fields by presenting the company with the choice of

> either going through its secondary recovery programme or negotiate the sale of its stock participation. *Texaco decided on the former.*[33]

In the period immediately following this ultimatum, Texaco, in addition to the start of secondary recovery work, brought a number of fields onto stream, including the Culebra, Auca Sur and Yuca fields (which had an estimated maximum allowable output rate of 8,000 b/d) and in 1981 completed its Yulebra discovery well.

Cepe, with its share of budget allocations increased, similarly adopted a more dynamic exploration and development programme. In 1979-81 Cepe discovered the Shuara, Shushuqui, Secoya and Charapa fields, which represented a combined productive capacity of 27,500 b/d, and the Sansahuari, Cuyaberio, Tetete-1 and Bermejo fields, which had a combined productive capacity of 19,000 b/d. As a result of these new oil finds, production in 1983 rose to a record level of 85.8m bls. With respect to future exploration and development work, Cepe committed itself in 1981 to a four-year programme of investment in the North-East ($150m); in the Gulf of Guayaquil ($250m — $400m); in secondary recovery; in the South-East ($300m plus); in the precretacic Eastern zone ($8m per exploration well); and drilling in the Central East area.

This spate of discoveries, which undoubtedly brought some respite to the oil crisis, helped foster a belief that, while it would be beneficial for the oil companies to return, there was less urgency attached to the attainment of this objective than the government claimed. But while Cepe's exploration during this period was reasonably successful to the extent that its resources permitted, it was nevertheless likely that reserves would increase only marginally since the traditional fields in the Amazon, particularly Lago Agrio and Sacha, were already showing signs of exhaustion. There was also a danger that, in the absence of substantial amounts of foreign investment, these discoveries would be developed slowly at a rate sufficient only to meet growing domestic demand and would therefore have no measurable effect on export levels. In the short term, however, Ecuador had little choice but to depend on Texaco and Cepe's exploration efforts to increase reserves. As the College of Economists in Quito noted in 1981, even if foreign investment were to make an early return to Ecuador there would be no measurable impact on reserves for a number of years:

> taking into account the fact that exploration takes time — between five and eight years — preceded by a negotiation stage before contracts are granted, then there is little likelihood that substantial improvements in the relation between production and oil reserves can be effected on the basis of new contracts by the end of the present decade.[34]

Given the time-lags involved and the fact that Cepe's resources were already stretched to the limit, the government made the first of a number of approaches to the World Bank and the IADB for loans to fund exploration and development work. Since extending its energy-lending policies in 1974 to include exploration and development, a number of Ecuador's neighbours had successfully approached the World Bank for funds. In 1980, Petroperú and the Bolivian state oil company YPFB received $32m each for exploration drilling and both Colombia and Brazil have received finance for seismic surveys. Since making its first venture into exploration activity in 1980, when the Jamaican state company Petrojam received $23.5m towards a three-well onshore programme, the IADB has also been an active lender for surface exploration, funding seismic surveys for large offshore tracts in Colombia, Brazil and Peru. Ecuador has so far been less fortunate, with its requests for loans rejected on the grounds that it has failed to meet the Bank's required policy conditions. When the first approach was made to the World Bank in 1980, the government was told that a loan would be considered only once major improvements were made to the management and efficiency of Cepe and when a more realistic domestic pricing structure for gasoline and other oil products had been introduced. More evidence was also needed that the country's spiralling external debt would be brought under control.

Under Roldós some steps at least were taken to reverse the country's low-price policy, despite violent opposition from students and the lower class who feared the impact that higher gasoline prices would have on transport fares. Even though fuel costs represented a fraction of total transportation costs, bus owners had warned that fares would be increased by the same multiple if fuel prices were increased. Price increases were eventually implemented in January, though the extent of the rise — pump prices increased by a mere 5 to 15 sucres — suggested that Roldós was merely preparing the population psychologically for a major price reversal. Although the annual growth rate of consumption slowed in 1980 to 10.3% compared with 14.3% in the preceding year, more substantial price increases were clearly essential if domestic consumption was to be brought under control. As a report by the Higher Energy Council in January 1981 indicated,

> the consumption of hydrocarbons has risen and continues to rise at an explosive rate which leads one to forecast that if these present rates of consumption growth and the current production figures are maintained, Ecuador in a few years' time will be a net importer of petroleum.[35]

The opportunity for more significant increases came a month after the Council's report when Roldós took advantage of the 'spirit of national unity' engendered by the conflict with Peru and tripled the price of gasoline and derivatives. Low octane gasoline was increased to 60 c, diesel fuel to 42 c and high octane gasoline to 80 c. Although the government tried to soften the blow by imposing a price freeze on a number of goods and services, violent clashes again broke out between police and students. As a result of these price increases the annual growth rate of gasoline consumption dropped between 1980 and 1981 from 11.1% to 2.4%. Substantial increases in the consumption of kerosene, residual fuels and distillate fuels, however, resulted in the overall rate of consumption rising by 11.8% in 1981, to 82,700 b/d.

That further steps would be taken to meet the Bank's policy on prices was inevitable not only because of the continued growth in consumption but also because of the government's increasing need to introduce revenue-saving measures to meet a mounting liquidity crisis. Even before Roldós's death in May 1981 and his replacement by Hurtado there were clear signs that the second oil boom was coming to a close as the tight supply situation of 1979-80 gradually gave way to a growing oil glut in the face of world recession and long-term trends in energy conservation and substitution. The subsequent depression in demand and prices had major repercussions for the Ecuadorian economy, the political structure and the oil-making process.

The 1982 Oil Law

The impact of the changing market conditions on Ecuador's oil prices began to make itself felt at the start of 1981. After peaking at $40.07 pb in January the average sales price of Oriente crude (29.7° API) fell to $39.37 and $38.24 in February and March respectively, and then in April to $36.2, $2 below the level on which government revenues for the year had been based. OPEC's belated decision to reduce its official market price from $36 to $34 pb did little to alleviate Cepe's increasingly acute marketing problems. With over six million barrels of unsold oil in its storage tanks, Cepe was forced to suspend production on 22 April for two days. Nevertheless, prices remained high enough for the rest of the year to push oil earnings up by 11.9%, from $1394m in 1980 to $1560m in 1981. It was at the start of 1982 that the full impact of the changed market conditions hit Ecuador, with oil exports falling in the first 45 days by 28% on the same period in 1981 to $134m. OPEC's attempt in March to maintain the $34 price level and its share of a shrinking market by announcing a production cutback and introducing a production quota system proved ineffective and left weaker members like Ecuador with little option but to 'cheat' on prices by resorting to 'hidden discounts' or on production by signing throughput agreements with refiners which would allow exports to appear as products rather than crude oil. Cepe was one of the first OPEC members to take the controversial step of selling oil at discount to alleviate marketing problems. On 3 May 1982, César Guerra, director-general of the Oil Ministry, publicly admitted that Cepe had sold 1.8m bls in the previous week at an average price of $32.20. A further breach in OPEC's efforts to maintain a united front on prices came just two months later when Cepe cut its oil price by $1.75 pb from $34.25 to $32.50 after pressure from long-term buyers in the USA.

The sharp fall in oil prices, together with the continued decline in the proportion of oil output exported — in 1982 this represented a mere 42.8% (90,100 b/d) of the 210,300 bls of crude produced daily — and weak prices for the country's traditional exports, were little short of disastrous for Ecuador. Crude export revenue, which represented 60% of the country's export earnings, fell by 11.0% to $1388.3m while total exports dropped by over 8% to $2343m. Between 1981 and 1982 GDP fell from 4.3% to 2%, monetary reserves slumped by 65% to just $210m, equivalent to less than one month of imports, and the current account deficit rose 18% to $1.18bn. By the last quarter of 1982, servicing on the $6bn external debt represented 122% of the value of Ecuador's export of goods and services, while nearly 25% of the budget for the year was allocated to debt servicing. In an attempt to alleviate the country's liquidity crisis, Hurtado followed his decision to sell oil at 'discount' by introducing an economic stabilisation programme which included a 32% devaluation of the sucre, the abandonment of numerous capital projects — many of which had been planned on the World Bank's assumption that oil prices would rise by 3% in 1981 — major cutbacks in public spending and restrictions on imports. In October, against the background of growing social unrest, Hurtado introduced an austerity package that included the doubling of gasoline prices, the removal of the wheat subsidy and a 53% increase in bread prices. Further measures were taken to deal with the balance of payments situation in 1983 after agreement was reached with the IMF and commercial bankers for a $170m one-year standby credit, the refinancing of part of the $6.5bn debt and new credit facilities. These included a 21% devaluation of the sucre in March, a 2% increase in commercial interest rates to 16% and a further package of austerity measures and import restrictions.

In terms of the government's plans to effect a speedy revision of the Oil Law, the deterioration in the economic and political situation helped erase any lingering doubts on the extent of the crisis facing the oil industry and the wisdom of luring foreign companies back to Ecuador. This was reflected in the evidence presented to the Economic Commission. With oil income forming over 60% of export revenue, 20% of the state budget and a sizeable proportion of the budgets of Cepe, Inecel, the universities, and numerous other organisations including the Consejos Provinciales, Banco Ecuatoriano de Desarrollo, Junta de Defensa Nacional and Municipalidades, there was general agreement among the participants in the survey that unless consumption was cut, the steady decline in export volume of oil exported halted, and new reserves found, the country would be plunged into economic and political chaos. One leading oil expert, Edgar Garrido, warned that if reserves continued to decline by 7% a year and the annual consumption growth rate remained at 15%, by 1987 Ecuador would be forced to import 40-50,000 b/d (20m bls a year) to meet domestic needs. Calculated at the February 1981 price of $38.4 pb this would represent a cost to the state of $770m (19,400m sucres). This figure is clearly too low, since it fails to take into account that the oil purchased at international prices would be sold at the lower, domestic prices and that the import requirement would rise with each succeeding year to meet rising domestic demand.

To tackle the problem of rising consumption, the Commission recommended the raising of domestic prices, the electrification of urban and interprovincial transport and a fundamental shift away from oil towards alternative sources of energy, principally hydroelectricity but also solar energy and biomass. With respect to reserves, another oil expert, Wilson Pastor, estimated that 450-700m bls, representing over $1,000m worth of investment, needed to be found between 1981 and 1986 — a task clearly beyond the capabilities of Cepe. In these circumstances there was general agreement that Ecuador had to draw up new oil regulations which were at least competitive with those of other countries — and this would have to include some type of production-sharing scheme — to attract investment from both state and private oil companies.

The changes to the Tax Law advocated by the government were considered by the Permanent Legislative Commission for the Budget which presented its own proposals on 24 June 1982. According to the Budget Commission's President, Wilfredo Lucero, these contained a number of incentives,

> one of which is to make the contracting companies subject to the general regulations of the Tax Law, thus enabling them to avail themselves of tax credit, eliminating at the same time double taxation for which they are liable under the present law.[36]

The Commission also proposed an additional, progressive tax, based on the level of production from the wells discovered (though crude oils of less than 15° API discovered were to be excluded from this tax), with the tax payable to be calculated by Cepe on the basis of official monthly production reports. The tax itself would not be deductible for the purposes of tax calculation.

On 6 August 1982, following the Economic and Budget Commission's submissions and against the background of a growing political and economic crisis, Congressional approval for reforms to the country's oil regulations was finally obtained. In the preamble to the 1982 Hydrocarbons Law it was stated that new terms and conditions 'in line with the most up-to-date and progressive of their kind currently applicable to the petroleum industry' were needed to induce both private and state companies to invest in Ecuador to revitalise exploration activity and thereby ensure the country's future economic and social development.

The package of incentives was based on a type of risk contract. Under this system the contractor is reimbursed for his expenses and investments by Cepe in cash from the output of the fields in the contract area once 'commercially exploitable' fields have been discovered. However, if the national interest is better served, payment can be made in oil or by a combination of cash and oil. Any payments in oil will only be made on part of the exportable balance of production from the contract area. If the contractor receives payment in cash he will have a preferential purchase option on up to 50% of the exportable balance.

A maximum of two contracts can be signed, one of which must cover an offshore area of not more than 400,000 ha, and companies must commit themselves to a minimum annual investment of $120 and $180 per acre, for onshore and offshore contract areas respectively. Given the size of the blocks eventually tendered this means a minimum investment of $24m onshore and $72m offshore during the first three years of exploration. The exploration period is four years, extendable by another two, and exploitation can last up to twenty years.

The Budget Commission's main tax proposals were fully incorporated in the law with the tax increment — that is, the rate over and above the ordinary (maximum) income tax rate of 44.4% — tied to the volume of production and not, as the government had proposed, to the size of reserves. Tax is zero on production below 30,000 b/d, 3% at 30,000 b/d, plus 1% for each additional 10,000 b/d up to a maximum of 30%. Oil of 15° API or less is exempt from the production tax. There is also a Labour Participation fee of 15% (in effect a royalty) which is deductible before payment of income tax and a 1% research tax on after-tax income. Overall, the effect of these changes is to bring down the total tax paid from 87% to around 75%.

Following Congressional approval for these amendments the government immediately announced that new exploration contracts would be finalised by September. In the event, changes at the top in the Oil Ministry and Cepe meant that a further five months passed before the new model contracts were drawn up. Although Parejo's replacement at Cepe, Rear Admiral Raúl Jaramillo, had a thorough grounding in the country's oil industry — he served as the military's representative on the

Cepe board — the same could not be said for Gustavo Galinda, who took over the Oil Ministry following Ortega's dismissal. Unlike his predecessor, Galinda, a civil engineer, was a novice in matters concerning oil. Delays, therefore, were bound to occur while he developed his knowledge of the oil industry and built up those personal contacts which are essential when doing business with outside investors.

Once the new exploration contract had been drawn up, in February, Cepe set 17 October 1983 as the deadline for the submission of bids for exploration rights in 11 blocks, 7 of which were onshore. Although 25 companies originally expressed firm interest, with a number of these, including Amoco and BP, purchasing the $50,000 information packages on both the onshore and offshore areas, the response was modest. By the close of bidding only 4 blocks, 2 in the Amazon and 2 offshore, drew bids. Belco of New York was the only bidder for two offshore areas immediately to the north of its Peruvian marine areas where it has been producing oil for about 20 years; the most popular block, number 15, which adjoins Texaco-Cepe's highly productive fields, drew competing bids from two consortiums, Conoco-Husky-Home and Idemitsu-Hispanoil, and from Occidental who finally won first option. Finally, Exxon and Hispanoil made a joint bid for Block B. Cepe officials were hoping that contracts would be signed sometime in August 1984.

Although presidential elections were scheduled for the start of 1984, company spokesmen appeared satisfied that the contracts, once signed, would be respected by the new government. The government policy of offering exploration rights to foreign oil companies had widespread support among the political parties and those candidates with significant chances of electoral victory, including the two front-runners for the presidency, León Febres Cordero and Rodrigo Borja. With the traditional export sector depressed by low prices and freak weather conditions and with oil representing nearly 70% of the country's total export revenue in 1983, there was general acceptance that a major successful exploration effort was the only way to boost foreign earnings and revitalise the economy. The start-up of production from Cepe and Texaco's new fields in 1983 has undoubtedly had a dramatic impact, at least in the short-term, on production and export levels. According to figures released by the Ministry of Natural Resources, production rose by 12% in 1983 to 235,260 while crude exports increased by a staggering 54%, from 90,100 b/d in 1982 to 139,200 b/d. However, although the rise in export volume helped compensate for the fall in oil prices — most of Cepe's sales contracts were signed at around $27-28.50 pb — and pushed crude export earnings up by 18% to $1644m, most observers recognised that, in the absence of substantial infusions of investment, Ecuador's production levels would start to fall after 1985.

Although the political risk was therefore considered small by some companies, it would be surprising if Ecuador's somewhat acrimonious relationship with foreign companies in the past had not caused many potential investors to refrain from bidding for exploration rights. More recent events, notably Jaramillo's letter to Texaco announcing that Cepe wanted to become operator for the consortium by 1985, can only have increased doubts concerning Ecuador's stability in respect of foreign companies operating there, even though provision for such an arrangement had been made in the original agreement. According to the *Petroleum Economist* this letter was apparently written 'without the knowledge of either the energy minister or of the President'[37] — further evidence of the confusion and inconsistencies that have long characterised Ecuador's oil-policy-making process. There were other reasons to account for what was a rather lukewarm response to the 11 blocks on offer. Some companies were undoubtedly disappointed by the new Oil Law and by the absence of any certainty that they would get access to the oil discovered in their contract areas. No significant concession on this vital issue was made, with the law still allowing the state to keep a sizeable portion of the oil discovered, and limiting a foreign investor's access to cash profits rather than to crude supplies. Some company officials also expressed concern with the pricing concept on which cash payments were to be based since the valuation of the oil would be dependent on the 'whim' of Cepe and its ability or otherwise to sell its oil on the world market at good prices. Similarly, in the event of payment in kind or the utilisation of the preferential purchase scheme, the price of oil was to be fixed in accordance with the average price obtained in the previous month by Cepe in its overseas sales. Companies were further disappointed to find that the provisions relating to gas deposits and the reinvestment of 10% of profits remained intact.[38]

The competitive environment in which Ecuador was seeking to attract investment also undoubtedly accounted for company reluctance to bid for the blocks on offer. Mention has already been made of the numerous opportunities available to oil companies in countries where the legal and political environment was far more favourable for investment. In any case Ecuador, along with most other Latin American countries, has never been a prime target for oil investors, a fact highlighted by the future investment plans of US oil companies outlined in the 24th Annual McGraw-Hill Summary of Operations in 1982. Even though vast amounts of oil still have to be discovered — one influential paper, by Dr. B.F. Grossling of the United States Geological Service, concluded that recoverable reserves for Latin America could range from 490 to 1,225bn barrels, compared with 74bn barrels so far discovered — the report predicted that capital spending in Latin America would rise only marginally in 1982 and then 'tail off sharply' in 1983-1984. Expenditure in Asia, on the other hand, would jump from $5bn to $13bn between 1982-1984, with nearly half of all oil company foreign capital spending being channelled into Indonesia, Malaya, South-East Asian countries generally and China in particular. In Africa expenditure was expected to double in 1982 to $3.4bn and thereafter flatten out at $3bn.

Ecuador's ability to attract the substantial quantities of investment needed to bolster the country's flagging oil industry has been further weakened by the worldwide slump in oil prices which has forced companies to reassess investment plans. With profits being squeezed companies have tried to alleviate their severe cash flow problems by reducing capital expenditure, thereby necessitating more selectivity in their choice of exploration ventures. While priority investment targets in Asia, North America and China are unlikely to suffer, the price declines have reduced the attraction of committing limited finance to developing high-cost fields in regions noted for political instability and thrown doubt on the commercial viability of marginal ventures. As the recent experiences of Ecuador's neighbours have shown, liberal oil regulations and good hydrocarbons potential are not, under current market conditions, sufficient to maintain, let alone attract, investment. After the drilling of a record 73 wildcats in 1982 exploration activity in Colombia has fallen sharply despite a number of highly promising discoveries by Occidental in the Llanos. One industry source predicted that it could fall by as much as 50-60%.[39] The changed market conditions have similarly slowed the momentum of exploration activity in Peru with a number of prospective deals with investors falling through during 1983. Earlier in the year Occidental announced a two-thirds reduction in drilling plans for the jungle and cancelled all drilling in the northwestern coastal fields. The reduced level of interest in Peru can hardly have anything to do with the country's oil regulations, which are extremely favourable to foreign investors. At the end of 1981, a spokesman for Occidental claimed that its Peruvian operations, though representing just 110,000 b/d, were the company's most profitable world-wide, owing to a production-sharing scheme that yielded better returns than, for instance, Libya and the North Sea.[40]

Cepe's continuing efforts meanwhile to obtain funds from the World Bank and the IADB have still proved fruitless. Despite the hefty increases in October 1982 in gasoline prices — Regular (63 octane) rose to 20 sucres (60 c), Extra (80-84 octane) to 30 sucres (90 c) and Super, the highest grade, to 40 sucres ($1.21) per gallon — the devaluations of May 1982 and March 1983, import restrictions, the removal of the wheat subsidy and a *de facto* moratorium on debt Bank officials have yet to advance any loans. In further negotiations in 1982 the World Bank demanded further revenue-saving measures and expressed concern that, despite its recent successes, Cepe still suffered from serious managerial and technical deficiencies. Whether there will be any funds available for exploration and development work once Ecuador fully meets the required policy conditions is open to doubt. Since President Reagan's election in 1980 both the World Bank and the IADB have been under increasing pressure to change their lending policies following a National Petroleum Council Report, commissioned by the US Energy Secretary, which claimed (though no supporting evidence was produced) that these policies 'were competing directly' with private oil companies in exploration and development ventures. Both Banks, it argued, should therefore confine their lending activities to infrastructural development projects though the NPC did acknowledge that they *may* have a 'legitimate' role in aiding pipeline, marketing and distribution efforts and in *some* cases perhaps taking on an advisory role on exploration.

It is not clear at this stage what effect this pressure will have, though since the USA is the main contributor of finance to both Banks, a fall-off in the amount of funds available for oil and gas development is a real possibility. There has already been a sharp fall-off in IADB energy-related lending since the peak level of $1,000m in 1981, with approved loans to this sector falling to $797m in 1982. Loans for oil and gas projects meanwhile fell from $147m to $134m, the latter representing one loan to Bolivia for an exploration and production project. Although energy-related lending rose by 21% in 1983 to $968m, loans approved to the petroleum sector slumped to $21.6m, their lowest level for four years.

Postscript

Quito's apparent satisfaction with the response to the 11 blocks on offer is understandable in view of the depressed state of the world oil industry and the competitive environment in which Ecuador was seeking large-scale investment. Nevertheless, the fact remains that, without more substantial quantities of investment, Ecuador's oil industry (and economy) faces an uncertain, and probably short, future. According to official estimates released at the end of 1983, total recuperable (proven) reserves stand at 1.1bn bls: with output averaging 254,000 b/d in the first half of 1984 this would suggest a reserve/production ratio of just 12 years. The new government of León Febres Cordero, which took office in August, will have to consider ways of offering more attractive terms to potential investors. Already many other Third World countries, recognising that further incentives are required to secure a share of shrinking investment funds, have sought to make their oil regulations more palatable to oil companies. Lower taxes and an increased company share in production are the two most obvious steps Ecuador could take to compensate for the decline in demand and prices and the depletion of cash investment. Perhaps a new risk contract could even contain a share in development costs. Whatever form the revisions may take, it is essential that their implementation not be hindered by any repetition of the delays that severely hampered the adoption of oil policy initiatives between 1976 and 1982. While the government delays matching the incentives being offered elsewhere, prospective investors can be expected to channel their limited funds to other parts of the Third World where terms are more favourable.

NOTES

1. G. Philip, *Oil and Politics in Ecuador, 1972-1976*, I.L.A.S. Working Paper No.1, p.21.
2. *Latin American Political Report*, 17 June 1977.
3. *Latin American Economic Report*, 18 June 1976.
4. *Financial Times*, 27 July 1976.
5. *Weekly Analysis*, 13 May 1977.
6. The balance of production in 1979, after taking into account crude exports of 122,600 b/d, totalled 27,800 b/d, representing oil product exports from domestic refineries; domestic crude processed abroad from which such products are retained; and stock change.
7. G.Philip, *Oil and Politics in Latin America: Nationalist Movements and State Companies* (Cambridge U.P.1982), p.488.
8. *The Times*, 10 August 1977.
9. Quoted in *Weekly Analysis*, 31 October 1978.
10. *Ibid*, 22 December 1978.
11. *Ibid*, 30 October 1978.
12. Quoted in *Petroleum Economist*, February 1978.
13. *Ibid*, December 1977.
14. *Weekly Analysis*, 13 May 1977.
15. Quoted in *Comisión Legislativa de lo Económico, Agrario, Industrial y Comercial: Consulta Nacional de Hidrocarburos, 1981-82*, p.29.
16. *Ibid*, p.30. Evidence submitted by la Superintendencia de Compañías.
17. 13 May 1977.
18. See 1978 Hydrocarbons Law.
19. 15 August 1977.
20. H. Handelman, 'A New Political Direction', in Handelman and Sanders, eds., *Military Government and the Movement Toward Democracy in South America* (Bloomington, Ind., 1981), p.32.
21. G. Philip, *Oil and Politics in Latin America*, p.292. Author's emphasis.
22. Survey on Ecuador, July 1980.
23. *Financial Times*, 10 August 1981.
24. 11 July 1979.
25. 12 May 1980.

26. Quoted in *The Guardian*, 22 June 1982.
27. Interview data.
28. *Weekly Analysis*, 19 December 1980.
29. *Ibid*. The principal wheeler-dealer in Carvajal's view was Robalino.
30. Quoted in the *Oil and Gas Journal*, 4 May 1981.
31. Quoted in the *Wall Street Journal*, 22 April 1980.
32. February 1981.
33. Quoted in *Weekly Analysis*, 19 December 1980. Author's emphasis.
34. Quoted in *Consulta Nacional de Hidrocarburos, 1981-82*, p.34.
35. Quoted in *Financial Times*, 10 August 1981.
36. Quoted in *El Comercio*, 24 June 1982.
37. May 1983.
38. Interview data.
39. *World Oil*, 15 August 1983.
40. See Frank E. Niering, Jr., 'Oil and energy in Latin America', in *Latin America & Caribbean 1983*, World of Information (Saffron Walden, 1983), p.32.

STATISTICAL APPENDIX

Table 1: Key Petroleum Indicators ('000 bpd)

	Output	Crude Exports	Consumption	% increase over previous year
1973	208.8	195.1(93.4)	29.3	10.6
1974	177.0	164.1(92.7)	32.2	10.0
1975	160.9	145.8(90.6)	38.4	19.3
1976	187.8	167.6(89.2)	44.7	16.4
1977	183.4	138.2(75.4)	53.3	19.2
1978	201.8	122.7(60.8)	58.7	10.1
1979	214.2	122.6(57.2)	67.1	14.3
1980	204.1	110.2(54.0)	74.0	10.3
1981	211.1	105.5(50.0)	82.7	11.8
1982	210.3	90.1(42.8)	83.1	0.5
1983	235.2	139.2(59.2)	N/A	N/A

N/A: not available at time of writing (mid-1984).

Source: *OPEC Annual Statistical Bulletin, 1983.*
Note: The figures in parentheses represent the proportion of output available for export.

Table 2: Proven Reserves (in billion barrels)

	(1)	(2)
1974	2.50	1.46
1975	2.45	1.40
1976	1.70	1.34
1977	1.64	1.27
1978	1.17	1.10
1979	1.10	1.03
1980	1.10	1.03
1981	0.85	1.00

Sources: (1) *Oil and Gas Journal* and *World Oil*. (2) World Bank.

Table 3: Oil Export Earnings (in $ million)

	Total Exports	Crude oil Exports	% share of total exports	Refined Exports
1977	1401	651	46.5	11
1978	1529	558	36.5	91
1979	2151	1032	48.0	146
1980	2544	1394	54.8	193
1981	2544	1560	61.3	167
1982	2343	1388	59.2	136
1983	2363	1644	69.6	106

Source: Banco Central.

Table 4: Domestic Oil Consumption (in '000 b/d)

	1977	1978	1979	1980	1981	1982
Gasoline	20.5	23.1	26.1	29.0	29.7	30.1
Kerosene	7.0	8.0	7.6	7.5	9.0	9.2
Distillate Fuels	11.9	12.8	15.0	16.8	17.9	18.0
Residual Fuels	9.2	11.6	14.0	15.5	20.4	19.5
Other	4.7	3.2	4.4	5.2	5.7	6.3
TOTAL	53.3	58.7	67.1	74.0	82.7	83.1

Source: *OPEC Annual Statistical Bulletin, 1983.*

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