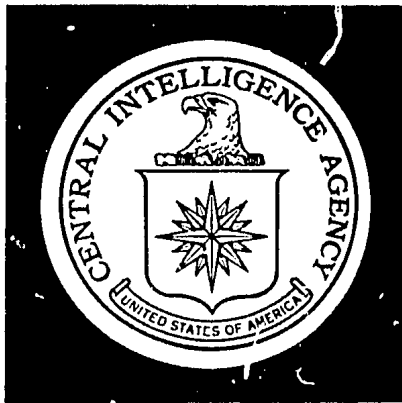


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2009/10/06 :  
CIA-RDP85T00875R00160001

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**DIRECTORATE OF  
INTELLIGENCE**

# Intelligence Memorandum

*Impact of the Drought in Ecuador*

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ER IM 68-80

July 1968

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CENTRAL INTELLIGENCE AGENCY  
Directorate of Intelligence  
July 1968

## INTELLIGENCE MEMORANDUM

Impact of the Drought in EcuadorSummary

Ecuador's newly elected president, Velasco Ibarra, faces serious economic problems as a result of a prolonged drought. Agriculture, the country's dominant economic activity and chief source of foreign exchange, has suffered production losses in rice, cotton, corn, oil seeds, coffee, and bananas. The government is belatedly attempting to ease the impact of bad weather through emergency imports of food and irrigation equipment, distribution of food supplies, and easy credit terms for agricultural loans.

At a minimum the drought will slow the economy's rate of growth in 1968, and it could well result in lower levels of production, investment, and consumption than in 1967. It also will aggravate existing budget and balance-of-payments problems. The budget deficit will surpass original estimates because of reduced tax revenues and increased relief expenditures, and the foreign trade surplus will be smaller because of lower export earnings and emergency imports. At the same time, the business community is apprehensive over the prospect of Velasco in the presidency because of his past record in this office. His candidacy and recent election have led some businessmen to cancel or delay plans for new investments, caused some capital flight, and heightened import demand in anticipation of devaluation or new import taxes. The latter actions, in turn, have reduced foreign exchange reserves and weakened the currency.

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*Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence.*

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### Introduction

1. When he begins his fifth term of office in September, Ecuador's former President Jose Maria Velasco Ibarra will immediately be faced by economic problems arising from the recent bad weather. A prolonged drought is seriously affecting Ecuador's agriculture, which accounts for one-third of gross domestic product and employs about 55 percent of the labor force. Some localities had no rain from March 1967 through February 1968 and have had little since then. The drought-stricken area embraces much of the coastal lowlands and inland valleys in southwestern Ecuador (as well as in northern Peru) and includes most of Loja Province and parts of the provinces of Guayas, Manabi, and El Oro (see the map). An estimated 75,000 Ecuadoreans -- or about 5 percent of the rural inhabitants in these provinces -- reportedly have left their homes, and many others are suffering in some degree from the drought. In isolated localities, food shortages are reported to have resulted in some deaths, particularly among young children already weakened by endemic disease.

### Impact on Agriculture

2. Rice, cotton, corn, and oil seeds are the principal crops affected by the drought, but there also has been some damage to coffee and banana crops. In addition, there has been considerable damage to pastures, which is likely to result in inadequate forage for cattle in the coming months. As yet, however, there has been no large-scale slaughter of herds. Cattle that can still be driven are being moved to other areas to graze.

3. Estimates by Ecuadorean officials as to the extent of crop damage are still incomplete and tentative. The Ministry of Agriculture and Livestock estimates that the winter rice crop will be about 45,000 metric tons, or 40 percent less than the 1967 winter harvest. Total rice production in 1968, including the summer harvest which usually begins in mid-August, is estimated at some 65,000 metric tons, a drop of 35 percent from production of 100,000 metric tons in 1967. The cotton harvest, which normally totals about 21,000 to 27,000 bales,

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may be reduced by as much as 50 percent. Ecuador usually imports some 6,000 bales of cotton annually from Peru and Colombia to meet domestic requirements, but total import requirements in 1968 are likely to be 16,000 bales or more. Production of oil seeds probably will be about 25 percent below the 20,000 metric tons produced in 1967. The extent of losses to corn, coffee, and bananas is not known but may be substantial.

4. Some inhabitants of the stricken provinces realize that they will have no harvest this year and are beginning to move out of the area in search of work. It has been reported that both national and provincial authorities oppose any mass migration from the area and that the army has been issued instructions to prevent such a movement. The army is, however, providing food and shelter to victims of the drought who have made their way to provincial capitals.

Direct Effects on Industry

5. The drought is also having some direct effects on industrial activity in the stricken area. Output of hydroelectric powerplants -- which serve mainly agricultural processors, commercial establishments, and households -- has declined because of lowered reservoir levels. The failure of grain and oil seed crops has depressed agricultural processing and presumably caused unemployment. Many local plants that process oil seeds are idle or have only small supplies on hand. Moreover, the shortage of waste from processing oil seeds has reduced production of cattle feed.

Government Reaction

6. Although the drought has continued for some time, the government only recently initiated measures to ease its effects. President Arosemena declared a state of emergency in April and appropriated about \$1 million for emergency relief. Government agencies as well as private organizations are making emergency distributions of food. To help relieve the rice shortage until the summer crop is harvested, the government canceled an authorized export of 10,000 metric tons of rice to Peru and Western Europe and

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has taken steps to import 10,000 metric tons of rice. In an effort to control speculative pricing practices by rice millers and traders, government authorities sequestered 20 percent of the millers' rice stocks and offered them for sale at reasonable prices. Ecuadorean authorities are also inquiring about the possibility of negotiating a new P.L. 480 sales agreement with the United States to cover imports on credit of wheat, rice, cotton, and tobacco. In recent years, Ecuador has received P.L. 480 commodities -- chiefly wheat, tobacco, and tallow -- valued at about \$1 million annually.

7. Other steps are being taken in an effort to limit or compensate for losses in agricultural output. The Ministry of Agriculture and Livestock is importing 10 metric tons of cotton seed and 8 metric tons of sesame seed for distribution to farmers in areas where replanting is feasible. In addition, the government is drilling wells for irrigation of those cotton and rice crops that possibly could still be saved. The National Development Bank has announced that it will extend existing agricultural loans and make easier credit available for the purchase of new seed and agricultural equipment, particularly irrigation pumps. The Bank has already arranged to purchase some 300 irrigation pumps from Czechoslovakia. The purchase amounts to about \$1 million, payable over five years, and probably falls under the credit of \$5 million extended to Ecuador in 1967.

**Economic Implications**

8. The drought will at least reduce the economy's rate of growth in 1968 below the average rate of 5.3 percent registered in 1963-67, and it may well result in lower levels of production, investment, and consumption than in 1967. Agricultural output will drop sharply, and the rate of industrial growth will slacken. The government could be forced to cut investment outlays for infrastructure projects, particularly roads, to obtain funds for drought relief. Investment in the private sector also could decline if the government finds it necessary to limit imports of capital equipment because of foreign exchange constraints. Personal consumption probably will suffer because available foreign exchange will

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not permit crop losses to be made up fully through imports. The per capita income of many peasant families in the drought-stricken area will decline, at least temporarily, from the current low level, which averages well under \$200 annually.

9. The drought also will intensify the government's chronic financial problems. The budget deficit in 1968 originally was estimated at about 811 million sucres (some \$45 million) -- an amount equal to about one-fourth of scheduled expenditures. It now appears, however, that the deficit will exceed that figure because of emergency expenses and reduced taxes from agriculture and other economic activities. Government borrowing from the Central Bank thus may increase this year, aggravating the problem of inflation. The cost of living in Ecuador has risen about 5 percent annually in recent years.

10. Reduced export earnings from coffee and rice and emergency imports of foodstuffs and cotton probably will make this year's trade surplus much smaller than the \$23 million achieved in 1967. This adverse prospect arises at a time when the sucre is already under pressure. The candidacy and subsequent election on 2 June 1968 of the unpredictable Velasco led to some flight of capital and has accelerated the demand for imports out of fear of devaluation or imposition of new import taxes. Import demand probably will remain strong for these same reasons, especially in view of the prospective large budget deficit. Ecuadorean businessmen recall that the last devaluation (from 15 to 18 sucres per US dollar) occurred in 1961, when Ecuador experienced a sharp decline in foreign reserves because of Velasco's expansionist monetary and fiscal policies. Recent pressures on the sucre are reflected in the decline of the rate of exchange in the free market from 21.80 sucres to the US dollar on 31 May to 23.50 sucres to the US dollar on 6 June, while the government maintained the official selling rate at 18.18 sucres.

11. Although psychological factors may provoke a devaluation, there do not appear to be any pressing economic reasons for it. Foreign exchange reserves

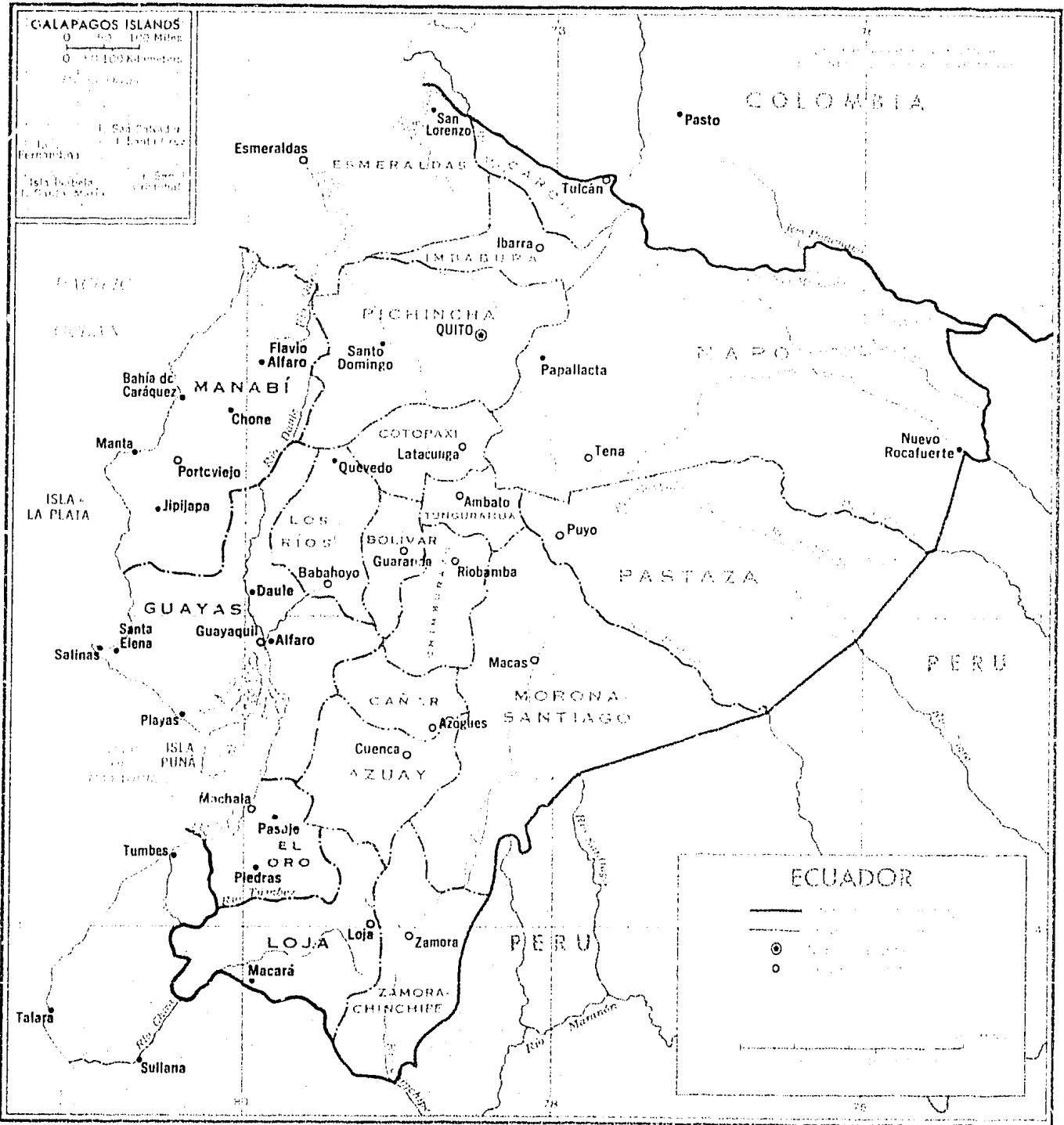


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have declined only moderately -- from \$69 million at the end of 1967 to \$58 million at the end of May 1968 -- and still are sufficient to cover three months' imports. Moreover, devaluation would do little to boost the value of Ecuador's exports because foreign demand for bananas, coffee, and cocoa (which account for 80 to 90 percent of total export earnings) is not very responsive to price changes.

12. The drought and related budget and balance-of-payments problems have occurred at an unfortunate time, in view of the election of Velasco. In the past, he has shown a tendency to surround himself with officials who were corrupt or showed poor judgment in economic matters. His attempts to promote public works and educational reform produced large budget deficits. In three of his terms, political battles with recalcitrant Congresses and subsequent resort to dictatorial methods led to the overthrow of his government. His election thus has created considerable apprehension among many Ecuadorean businessmen. Some business interests fear that their influence over economic policies will decline and their access to government favors will diminish. Uncertainty about Velasco's economic program already has caused some businessmen to cancel or delay plans for new investments. Because of the drought and this atmosphere of distrust of the new administration, the short-term prospects for economic progress in Ecuador are dim.

### PROVINCES MAINLY AFFECTED BY THE DROUGHT



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