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Ecuador and China: BFFs and Champions of the 21st Century Socialist Agenda

Ecuador is a beautiful country with a rich and diverse culture, geography and history. My wife is from Ecuador, and I can't say enough about the friendliness and generosity of her family and many others that I've met from Ecuador. My hope is to someday visit the country, God willing, and take in all the sights, sounds, smells and experiences that up until now, I have only experienced through the anecdotal, photographic and video evidence.

However, I feel that my timetable and window for visiting the country is rapidly closing. If things continue in their current economic and political direction under President Correa, there may not be any socio-political stability left, not to mention the inevitable deterioration of the economy that always accompanies centrally-managed socialist states. See Cuba and Russia for good examples. Moreover, I may have to learn Chinese in addition to Spanish to get around the country. So what exactly is going on in Ecuador? Didn't Rafael Correa make everything better?

President Correa's Vision

Leftist President Rafael Correa of Ecuador easily won a second term as president of Ecuador on February 16th with 56% of the vote compared to the 23% of his closest competitor, Guillermo Lasso, a banker from Guayaquil.¹ Now President Correa will be able to continue his radical socialist agenda for another four years in Ecuador, especially if his party strengthens their hold on the Assembly. Not everyone in Ecuador is happy about that.

“There is a lot of apprehension that if he wins the Assembly, there will be a greater concentration of power,” said José Hernández, an editor of *Hoy*, a Quito daily newspaper. “He will try to flatten everyone who is in his way. He will try to dominate more because that's his personality, and that's what he wants to do.”² So just who is Rafael Correa?

President Correa is a self-described 21st Century Socialist who studied Economics at the University of Illinois, and he's certainly no fan of Western economic policies, especially those of the United States and the International Monetary Fund (IMF). A tripling of the price of Ecuador's oil exports has allowed Correa to follow through on many of his campaign promises to redistribute wealth to the poor; invest in health care, education and infrastructure; lower the poverty rate to 28% from 36% (still pretty high); lower the unemployment rate to 4.14% from 8.8%; rewrite the National Constitution and transform the criminal justice system. Sounds good so far, right?

¹ (Neuman, President Correa Handily Wins Re-election in Ecuador)

² (Neuman and Ayala, Ecuador's President Shows Confidence About Re-election, Too Much for Some)

“According to Capital Economics, a consultancy, “there are reasons to question whether Correa’s ‘socialist revolution’ is built upon sustainable economic foundations.”³ The “sustainability” question is doubly relevant, because Correa has built the economy on heavy government spending, reliance upon Chinese loans, additional taxation of the banking and banana exporting sectors, and, most importantly, a current spike in oil prices. Correa exclaimed, “Nothing, nobody, can stop this revolution,” from the balcony of the presidential palace in Quito after the elections.⁴

Well, nothing except a decline in the price of oil which accounts for 50 percent of Ecuador’s export earnings and 40% of its public sector revenues?⁵ Or maybe China calling in its massive loans of over \$9B to Ecuador. Ramiro Crespo, head of Analytica Securities in Quito adds, “We cannot keep relying on high oil prices and China’s ‘generosity’.”⁶ No kidding. A lack of broad diversification in the economy combined with the over-taxing of Ecuador’s best industries, signing horribly one-sided loan deals with China, and defaulting on billions of dollars of sovereign debt are recipes for economic disaster not economic recovery.

Will Anyone but China Invest In Ecuador?

It’s worth noting at this point in the article that Correa had Ecuador default on \$3.9B worth of sovereign debt in 2008 in order to free his country from an “unfair” and “immoral” debt situation.⁷ Correa has reversed the moral judgment on this one. I thought it was immoral to default on debt, but in Correa’s world, the lenders were immoral for loaning Ecuador the money. How do you think this odd economic philosophy has gone over with potential global investors?

“Foreign direct investment (FDI) has generally been less than \$1 billion a year since Correa took office in 2007. By comparison, neighboring Peru and Colombia last year received \$7.7 billion and \$13 billion, respectively.”⁸ To make things worse, the World Bank reports that Ecuador’s FDI slipped below \$200 million in 2010 and 2011. Ouch! If you can’t attract FDI, you have to either tax your citizens and corporations heavily to keep running the country, increase costly government deficits that further exacerbate the problem, or borrow from a real international loan shark like China. President Correa has chosen to do all of the above. Things look a little better in the short-term, barely, but the long-term costs of this strategy are going to be pretty exorbitant.

Correa’s Welfare Generosity

Correa wouldn’t be winning elections if he wasn’t doing something to impress Ecuador’s urban poor. Correa recently raised the human development bond payments (similar to welfare) from

³ (Schipani)

⁴ (Schipani)

⁵ (Central Intelligence Agency)

⁶ (Schipani)

⁷ (Central Intelligence Agency)

⁸ (Garcia and Ellsworth)



\$35 per month to \$50 per month.⁹ This translated into lots of votes for Correa in the February election, but the program isn't free. Neither are free medicine handouts, increases in social security pensions, free school lunches, an increase in the housing bond, huge infrastructure projects, or a free national literacy program. So how is Correa paying for it? He started, as stated earlier, by defaulting on \$3.9B of Ecuador's sovereign debt, buying back the global bonds at deep discounts, and then accumulating whole lot more debt from riskier sources like China while distributing some of the savings to the poor and lower classes.

The Financial Times reports that "Ecuador's government spending has almost doubled as a percentage of gross domestic product – from being the lowest to the highest in Latin America – deepening the budget deficit to more than 7 per cent of Ecuador's \$76B economy."¹⁰ So how do you finance a \$5.3B government spending deficit when your name is dirt on the international financial markets and nobody wants to lend you any money?

Felix Salmon from Reuters reports that Ecuador has borrowed over \$8B from China since Correa took office on cash for oil programs.¹¹ Moreover, Ecuador's Finance Minister, Patricio Rivera, recently said, "The country will finance its [2013] budget deficit using a \$2B loan from the Chinese government. The gap between government spending and income is set to rise by approximately \$6B in 2013, which is 7.75% of the projected GDP for next year."¹² And that's if the price of oil doesn't fall. I guess desperate times call for desperate measures. Ecuador's children and grandchildren will be paying for Correa's insatiable appetite for new debt.

China – Ecuador's New BFF

President Correa should have called some key African leaders in countries like Nigeria, Zambia, Angola and the Congo to see how the whole 'cash-for-oil/resources' scenario typically works out. I'll give you a hint. China *always* gets the better end of the deal. See [my article](#) for more info on this. When Chinese investors saw these current deals that Correa signed, it must have been a true test of self-control to hold back their own drool in lustful anticipation and/or their derisive laughter at how one-sided the deals were in their favor. The *El Universo* newspaper reports that the China Development Bank oil loans are "tied to another 72,000 barrels per day of oil deliveries ... That would make Ecuador owe 75% of its oil exports to China."¹³ Wow!

So not only does Ecuador have 20% of its GDP tied up in loans to China, but they have to give them 75% of their oil. Astonishing! Was Rafael Correa asleep in his economics classes at the University of Illinois? How could he do this? I mean, think about it. What if another oil investor wanted to buy Ecuador's oil, maybe one country like the U.S. or maybe a consortium of countries, at a higher price for greater than 25% of the output? Can't do it. Correa has backed

⁹ (Gottinger)

¹⁰ (Schipani)

¹¹ (Salmon)

¹² (Powell)

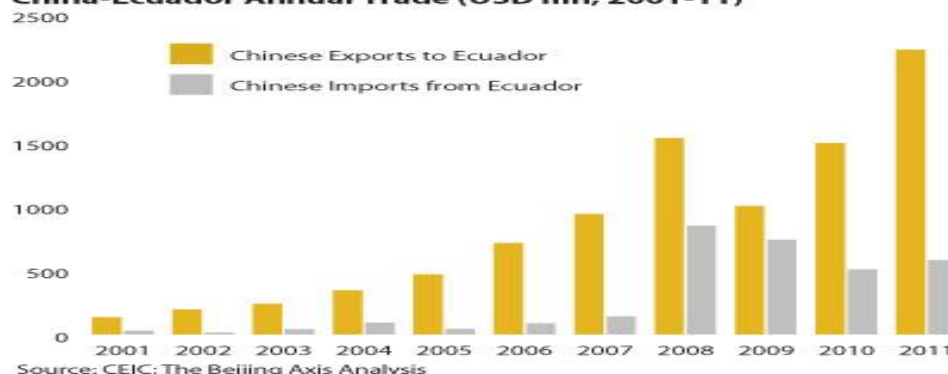
¹³ (Salmon)

himself and his country into a corner. He only has 25% of his product free to make better deals. In short, he has no flexibility. The Chinese have him over a barrel, literally.

Felix Salmon adds, “This is something which happens when sovereigns default: they risk losing their sovereignty. *Ecuador now resembles a wholly-owned subsidiary of China*, much like many solvency-challenged yet resource-rich countries in sub-Saharan Africa. And a glance at Greece is enough to see how that country has essentially ceded much sovereignty to the EU.”¹⁴ And it’s actually worse than that.

As you can see from the chart below from CEIC, China’s exports to Ecuador have increased to about \$2.25B while China’s imports from Ecuador are roughly \$580M, and the trends are definitely growing in the wrong direction. China loves to fill the shops and stores of foreign countries with its cheap goods, and they don’t really care if those local stores, or the local vendors that supply those stores, go out of business. This is how local jobs eventually get exported to China. When I go to Ecuador, I expect to see genuine Ecuadorian products *made in Ecuador* for sale in the markets, not Chinese knock-offs. I get enough of that here in the U.S.

China-Ecuador Annual Trade (USD mn, 2001-11)



Robbing Peter (the Banks) to Pay Paul (China)

Not only has Correa been borrowing a lot of money from the Chinese, he’s also been ~~stealing~~ borrowing a lot of money from the banks as well. Despite already paying an estimated 80% of their profits to the state in fees and taxes, Correa decided that wasn’t quite enough. The President stated his philosophy clearly: “Those who are earning too much will be giving more to the poorest of this country ... The time has arrived to redistribute those profits.”¹⁵ Quito attorney Gilberto Albornoz added, “It’s good that the bankers help the poorest,” he said. “They turn themselves into millionaires with the money of the people and they should contribute to the country and the poorest.”¹⁶ Yeah, but a whole lot of lower and middle income citizens work for the banks. They also depend on bank financing to start businesses.

¹⁴ (Salmon)

¹⁵ (Bajak and Solano)

¹⁶ (Bajak and Solano)

Predictably, Ecuador's banking sector profits dropped 21% from \$393M in 2011 to \$312M in 2012. In case you're keeping score, that means the 'bank tax' only pulled in additional \$81M for wealth redistribution assuming profits held steady from the prior year. Ecuador needed a whole lot more than that to fund Correa's programs. Unfortunately, Correa's taxation programs most certainly cause far more harm to the poor than any good the extra welfare payments bring. The facts are that the Ecuadorian economy grew at a real GDP rate of 5.2% from 2002-2006 *before* Correa took office, and has averaged about 5% *after* he took office, including a rate of only 4% in 2012.¹⁷ It's only up when oil prices are up. That speaks to the economy's fragility, not to mention the risk of putting all of your eggs in one basket with China holding the strings. Simply moving the old wealth around without creating genuine new wealth is just a mirage. And *it hurts the poor*, the very people Correa claims to be helping.

Don't Banks Help Create Jobs?

Bajak and Solano report, "Produbanco's president, Abelardo Pachano, told the newspaper *El Comercio* that the proposed [bank] tax would "destabilize the banking industry, weaken it and clip its wings." The victims would be Ecuador's 7 million depositors."¹⁸ An Ecuadorian banking analyst added, "The Ecuadorean financial system is becoming less attractive to foreign investors because it is highly regulated and there are continuous rule changes ... this could reduce banks' loan growth, leading to a slowdown in the economy while also jeopardizing the health of the financial sector."¹⁹ Correa has already hurt the banks by "setting interest rates and increasing the services that banks must provide to clients for free."²⁰

The problem with this strategy is that banks provide the fuel for entrepreneurship and job growth by giving qualified borrowers commercial financing to follow their dreams. Banks can't give every service away for free, and they have to be able to charge higher rates in some situations to compensate for greater risk. The more the state tells the banks how to run their business by over-regulating them and telling them who gets loans, what services they should provide, and what interest rates to charge, enormous risk has been added to the equation and removed the incentives for banks to make loans. Nothing will kill an economy quicker than to handcuff the banks.

Ease of Starting a Business in Ecuador

Outside of the oil industry, just how bad of an environment is Ecuador for entrepreneurship? According to the Heritage Foundation, [Ecuador's Economic Freedom Index](#) score is 46.9, good for the 159th freest in the 2013 Index and 26th out of 29 countries in the South and Central America/Caribbean region.²¹ The Index measures the level of regulatory efficiency, rule of law,

¹⁷ (Central Intelligence Agency)

¹⁸ (Associated Press)

¹⁹ (Associated Press)

²⁰ (Associated Press)

²¹ (The Heritage Foundation)

open markets and limited government. The World average is 59.6 and the regional average is 59.4.²² Thus, Ecuador finds itself behind such global economic juggernauts as Ethiopia, Haiti and Bangladesh. Regionally, Ecuador ranks behind Peru, El Salvador and Barbados. Those countries aren't blessed with substantially more natural resources than Ecuador. Quite the opposite. Ecuador should be running circles around some of those countries. Correa is paying for more citizens to get a free education, and that is good for reducing illiteracy, but for what purpose if they can't find a good job or start a new business at the end?

The Heritage Foundation added in their 2013 write-up for Ecuador:

Once considered moderately free, Ecuador has slid significantly in the rankings and continues for a fourth year as a “repressed” economy. The reach of government continues to expand to economic sectors beyond the petroleum industry, and pervasive corruption continues to weaken property rights. The private sector has been marginalized by a restrictive entrepreneurial environment. Ecuador's underdeveloped financial sector, often subjected to state-directed allocation of credit, limits access to financing and adds costs for entrepreneurs.²³

The World Bank confirms the Heritage Foundation data through their own “[Ease of Doing Business](#)” global rankings which measures the ease of starting a business, dealing with construction permits, registering property, getting credit, protecting investors and enforcing contracts among other criteria.²⁴ Ecuador scores 139 out of 185, ranking behind Yemen, Cambodia and Vietnam.²⁵ Ecuador also scores 29th out of 33 “Latin America and Caribbean” states with Venezuela bringing up the rear in 33rd and Chile leading the way in first place.²⁶

Incidentally, Correa dedicated his election victory to Venezuelan President Hugo Chavez,²⁷ but hopefully Correa isn't asking Chavez for any advice on how to run a (socialist) economy. Moisés Naím of the Carnegie Endowment for International Peace said, “President Chávez has bequeathed the nation an economic crisis of historic proportions.”²⁸ Analyst David Frum added, “Despite vast oil wealth, the Venezuelan economy has tumbled into terrible straits. Inflation roars at 25%, unemployment exceeds 8%, the non-oil economy stagnates, electricity flickers on and off irregularly, and basic commodities such as rice and beans have become scarce in the marketplaces and must be obtained as rations from government-controlled stores.”²⁹

²² (The Heritage Foundation)

²³ (The Heritage Foundation)

²⁴ (The World Bank)

²⁵ (The World Bank)

²⁶ (The World Bank)

²⁷ (Garcia and Ellsworth)

²⁸ (Walser)

²⁹ (Walser)

Socialism – Not a Good Way to Run an Economy

Despite all of the warnings from history such as the collapse of the Soviet Union at the end of the Cold War and the modern day examples of Venezuela (Chavez) and Cuba (Fidel Castro) in Rafael Correa's own backyard, and North Korea, he indeed seems hell-bent on following their examples. The State Department's economic report of Ecuador states:

Articles 313 through 315 of the 2008 Constitution establish that the State is responsible for management of "strategic sectors" through state-owned or controlled companies. Strategic sectors identified include: **energy** in all its forms, **telecommunications**, and non-renewable natural resources (includes petroleum, natural gas, and **mining**), **transportation**, hydrocarbon refining, **media**, water, and biodiversity and genetic patrimony. Within the last few years, new state companies have been formed in mining, pharmaceuticals, and the **banana** sector.³⁰

This is truly incredible. Who is left in Ecuador's workforce who doesn't work for the state? Rafael Correa wants to run the banks, the energy companies, the banana companies, the transportation and mining companies, and *the media*?! Seriously, the media? This is not the kind of democracy where free speech is protected. And Correa's doctorate in Economics from the University of Illinois at Champagne/Urbana no more qualifies him to run that entire list of industries than Buzz Lightyear or Ronald McDonald. The famous Austrian economist Ludwig von Mises described this type of economy the best:

Where there are no market prices for the factors of production because they are neither bought nor sold, it is impossible to resort to calculation in planning future action and in determining the result of past action. A socialist management of production would simply not know whether or not what it plans and executes is the most appropriate means to attain the ends sought. It will operate in the dark, as it were. It will squander the scarce factors of production both material and human (labour). **Chaos and poverty for all will unavoidably result.**³¹

The best thing that could happen to Correa's social development programs would be for thousands of poor people to become gainfully employed, start businesses, and become financially independent enough to not need the government programs anymore. But that is unlikely to happen under Correa's watch, not unless you have two jobs. Although the unemployment rate was 4.14% in 2012, the underemployment rate, or "the percentage of Ecuadoreans employed in the informal sector or who work on an occasional basis, stood at

³⁰ (U.S. Department of State - Bureau of Economic and Business Affairs)

³¹ (Mises)

51.37% in December 2012, compared with 54.66% in the year-earlier period.”³² Thus, the lower unemployment rate is clearly masking a deeper problem in Ecuador’s economy.

The underemployed will still need the government, errr ... Mr. Correa, to get by. That is not a stable economic situation. State ownership of key sectors of the economy also contribute to a lack of productivity that would open up more jobs for citizens. Moreover, the infrastructure jobs Correa created are temporary, and the Chinese will bring their own workers to build the Pacifico oil refinery if Correa ever gets that deal signed. Don’t get me wrong – it’s better to have a part-time job than no job at all, but the unemployment rate doesn’t tell the full story in Ecuador. But then again, Correa doesn’t care that you know the full story.

Rafael Correa – Media Masher

Correa has filed high profile lawsuits against the newspaper *El Universo* for daring to call him a “dictator”,³³ and the authors of “Gran Hermano” (Big Brother) when they claimed that Correa knew of multi-million dollar contracts his brother had with the government.³⁴ The four defendants in the *El Universo* case received three-year prison sentences and were charged \$40M worth of damages, but Correa eventually pardoned them under public pressure and dropped the lawsuit against the Gran Hermano authors.³⁵ Needless to say, that would have a chilling effect on freedom of the press.

Apparently, Correa doesn’t take too well to criticism, so the easiest way for him to deal with it is to use his despotic power to shut it down. Inter-American Press Association President Gonzalo Marroquin described Correa’s efforts as follows: “This is a “systematic and hostile campaign to do away with the independent press and establish, by law or through the courts, ownership of the truth that all the Ecuadoran people must swallow.”³⁶ Without a doubt, it’s certainly not a style that respects different opinions.

Is Correa Doing the Lord’s Work?

Certainly Correa has taken a lot of heat for many of his policies not only internally within Ecuador, but externally on the global stage. So why does Correa persist in tired, old socialist policies that have proven themselves historically to destroy wealth and expand poverty at the expense of his country’s economic health and global and regional prestige? When asked about how new corporate taxes would be applied to fund his social agenda, Correa proudly said in his weekly TV and radio show, "My duty is to the poor," and indicated “his politics are guided by

³² (Alvaro)

³³ (Jose)

³⁴ (Medel)

³⁵ (Censura en Ecuador: El Universo)

³⁶ (Washington Post)

the teachings of Christ” while calling out “well-known Ecuadoran banking families that would be hit [by the taxes], “the Pachanos, the Egas and the Lassos.”³⁷

Playing favorites and calling out “rich” families who are tax targets sounds more like jealousy, greed and sour grapes than Christianity. In fact, it’s prohibited by Scripture. Leviticus 19:15 says, "Do not pervert justice; do not show partiality to the poor or favoritism to the great, but judge your neighbor fairly." The Bible instructs individual Christians to love and care for the poor, but the state isn’t supposed to carry the lion’s share of the responsibility. Isn’t voluntary giving a far better solution than mandatory forced giving through unfair confiscation of wealth?

Mike Warren describes the Biblical model for poverty relief:

There was no state welfare system under the Law of Moses. The poor could glean from the fields after the harvest (Leviticus 23:22), they could hand-pick and eat from the crop growing in a farmer’s field (Deuteronomy 23:24-25; Matthew 12:1); they could receive zero-interest, collateralized loans (Exodus 22:25-26); and every third year the priests collected a tithe that was set aside for the poor (Deuteronomy 14:28-29). The State did not collect taxes from the rich to redistribute to the poor. A tax rate of less than ten percent, as required by 1 Samuel 8, would not allow for such a welfare program.³⁸

Warren adds that individuals, families and churches have the primary responsibility for caring for the poor.³⁹ “Religion that is pure and undefiled before God, the Father, is this: to visit orphans and widows in their affliction and to keep oneself unstained from the world” (James 1:27). This type of pure and undefiled religion uplifts human dignity instead of undermining it.

I highly recommend reading more of [Mike Warren’s article](#) on the subject for more information about these concepts. Of course, it goes without saying that the goal of socialism is for the state to become the provider, to take the place of God in effect. This is not the state’s place. I believe in a very limited government safety net to help retirees, the poor and the very needy, but not in one that is leveraged by elite politicians for political purposes. That would seem to be the highest form of corruption and certainly not very Christian. The American welfare system does a great deal of good, but let’s be honest. It is also marked by rampant corruption and fraud. Many people receive benefits who shouldn’t. The whole system needs reformed. This is a subject that deserves its own 10-page paper to address sufficiently.

Ecuador – A National Security Threat?

It’s one thing if Rafael Correa merely wants to try out a socialist economic experiment on his own people, thumb his nose at the West, and see how things turn out, but Correa has gone further in his experiment by becoming part of an exclusive economic and political ideological club of

³⁷ (Bajak and Solano)

³⁸ (Warren)

³⁹ (Warren)

21st Century Socialist elites that hate the entire Western system and what it stands for. You know the club and all of its familiar faces like Hugo Chavez, Fidel Castro, Daniel Ortega and Mahmoud Ahmadinejad, the President of Iran.

After Ahmadinejad called and congratulated Correa on his re-election, Iranian Foreign Minister Ali Akbar Salehi said, “Diplomatic relations between Iran and Ecuador are at their highest level ever.”⁴⁰ I wonder if Iran will build some schools and military training facilities in Ecuador like they do in Venezuela.⁴¹ Upon receiving criticism for his ties to Iran, Correa said, “The government of Ecuador will do whatever it sees fit [to be done] for the country without seeking permission from no one.”⁴² I’m sure that made all those potential global investors like Canada (for the Pacifico oil refinery) really comfortable.

U.S. Director of National Intelligence James Clapper provided this warning in his Senate testimony: “The Iranian regime has formed alliances with Chavez, Ortega, Castro, and Correa that many believe can destabilize the hemisphere ... These alliances can pose an immediate threat by giving Iran—directly through the IRGC, the Qods force, or its proxies like Hezbollah—a platform in the region to carry out attacks against the United States, our interests, and allies.”⁴³ Latin America is certainly playing a much more prominent role in Tehran’s planning and global activities, and the U.S. is paying very close attention.

Conclusion

Ecuadorean President Rafael Correa said his party “will steamroll through reforms that will make his socialist model irreversible.”⁴⁴ That is bad news for Ecuador. Correa’s playbook for economic growth has been tried in many other places before and has failed miserably. Wealth redistribution is a divisive fantasy that only pads the pockets of elites like Correa and his cronies and is neither Christian nor just in any sense of those concepts.

Critics will point to all the new roads and schools in Ecuador, the reduction in the illiteracy rate, unemployment rate and poverty rate, the new hospitals, and the new level of political and economic ‘stability’ and claim that I don’t have a case. That would be short-sighted to say the least. I’m not saying Correa hasn’t done anything good at all. He has. But at what cost? The fact that Correa had held onto power so long when the country had 7 presidents in 10 years says more about the prior leaders than it does Correa. Socialism just doesn’t work long-term. Capitalism has fed millions upon millions more mouths than socialism will ever hope to feed.

Correa’s “cash-for-votes” political strategy that is built upon the very risky “cash-for-oil” borrowing strategy will undoubtedly raise expectations to a level Correa cannot hope to satisfy if

⁴⁰ (Tehran-Quito relations at highest level: Iran FM)

⁴¹ (Berman)

⁴² (Press TV)

⁴³ (Berman)

⁴⁴ (Garcia, Ecuadors' Correa Vows to Make Socialist Revolution Irreversible)

the price of oil goes south. Right now 80% of the population approve of Correa, but they haven't seen the long-term damage yet. The lie of socialism is that if the profit motive of capitalism can be replaced with social justice, and if the means of production are transferred (primarily) to the state, there will be peace and harmony for all. I haven't even addressed Ecuador's serious crime problem (maybe another day), and pervasive crime is often fueled by urban poverty. But individual citizens will still have ambition and desire to be something more than just another person receiving a government handout. That is a good thing. The state can never kill that. It is when that desire and ambition are released in a genuine environment of achievement that true economic reform can take place.

Lorenz Kraus said, "By their nature, capital goods cannot be redistributed among the people in any sense that results in equality and wealth. The redistribution of wealth, if taken seriously, necessarily means the complete and utter destruction of wealth. Socialism *is* nihilism, the destruction of values."⁴⁵ As the Ecuadorian state continues to monopolize and centrally manage vast categories of businesses, and Correa continues to sign questionable loan deals with China, the economy is on course to further collapse into dysfunction, unnecessarily deepening and expanding poverty across the country. Perhaps the people will wake up before it's too late. Viva la Ecuador!



Rafael Correa and Mahmoud Ahmadinejad

⁴⁵ (Kraus)

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