Boom & Bust: Ecuador's Financial Rollercoaster

The Interplay between Finance, Politics and Social Conditions in 20th century Ecuador

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Vernon Press

www.vernonpress.com

In the Americas:
Vernon Press
1000 N West Street,
Suite 1200, Wilmington,
Delaware 19801
United States

In the rest of the world
Vernon Press
C/Sancti Espiritu 17,
Malaga, 29006
Spain

Library of Congress Control Number: 2015942450

ISBN: 978-1-62273-470-2

Synopsis

This work proposes a connection of financial circumstances with major socio-political events in 20th-century Ecuador. It highlights the state of the nation's economy as a determinant factor in the outcome of events. Throughout the history of Ecuador, the ambivalent evolution of major political and social events such as the stability of serving presidents, coups and war, has had an interesting and direct relationship to the financial environment. If the economy was healthy, did the country also experience stability? If it went into disarray, did the non-financial environment follow? Data collected from the Central Bank of Ecuador, unpublished diplomatic papers, and personal documents from relevant historical figures, as well as from the work of previous historians, indicate a strong effect of financial and economic performance on major political and social events. Particularly, given the country's dependence on three main commodities: cacao, bananas and oil, the performance of these significantly shaped 20th-century Ecuadorian history.

To my mother and grandmother

Acknowledgements

I would like to acknowledge all the people who in one way or another helped me complete this book. Mention is needed for my family, whose support has allowed me to complete this work, especially my grandmother, mother, and uncle. I would also like to acknowledge all the people at the different universities that have aided me in the research, especially Professor Candelaria Garay at Harvard University for all her wonderful support.

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Chapter 2

The Age of Crises (1925-1948)

The Julian Revolution on July 9, 1925, put an end to the liberal era that had ruled Ecuador for 30 years. The *tiranía bancaria* was blamed for the misfortunes of the country, but even with all the efforts directed towards disassembling the banking elite, the true reasons for the financial catastrophe that were afflicting the nation could not be ignored. The liberal revolution had failed to bring a progressive transformation to Ecuador. Even with all the infrastructure projects in which the nation's money was spent, a real solution to the country's core problems was nonexistent. The completely inadequate system of public finances, and the inability to free the country from the export sector as the only significant generator of wealth in the economy ended the liberal rule in Ecuador with an out-and-out crisis.

Ecuador would succumb into a period of dreadful events, a disastrous handling of finances, and with cacao absent as a significant financial propeller, instability and suffering is what awaited Ecuadorians. During this time, the changeover of heads of state was a common occurrence, with many of the men leading the country lasting merely months in power. Not even the clamored and respected Kemmerer mission, intent on organizing the nation's finances, was able to survive this chaotic period in Ecuadorian history. Internal instability notwithstanding, in 1941 the country would find itself amid a severe quarrel with Peru. Not being able to organize a proper diplomatic team, and worse, unable to fund a proper military, the Ecuadorian nation would face perhaps the harshest blow in its history.

The years following the overthrow of President Córdova in 1925 initiated a period of change. The "corrupt coastal oligarchy," as the new leaders proclaimed, could no longer enjoy their profits at the expense of the Ecuadorian people; the bankers could no longer hold at their discretion the country's money supply. At the core of the reforms that were to be enacted was the creation of a central bank that would end old regionalist politics and initiate Ecuador's path towards modernization. Consequently, the new regime invited a celebrated team of North American advisers led by Edwin Walter Kemmerer to study the

Ecuadorian situation and suggest the reforms needed to modernize Ecuadorian finances.

Also known as the "Money Doctor," Kemmerer advised countries all over the world. Most famously, he was pursued to help with the financial stabilization of Poland after the First World War, which was in need of new loans, and burdened with a host of unresolved issues. Also on his résumé were missions in Egypt, Germany, India, Mexico, Puerto Rico, and South Africa, among others. Most important for Ecuador, however, were those of Chile, Colombia, and Guatemala, which were considered the blueprint of what needed to be done in the country. The Money Doctor would arrive in Ecuador with the purpose of his mission clear, and his suggestions would become the cornerstone of Ecuadorian reform that would steer the country into the direction it would take the following years.

The Kemmerer Mission and Institutions.

The Julian Revolution was followed by a period of aftershocks; two provisional governments would take power before a new president would be put in office. This period of post-revolutionary politics quickly ostracized the original form of the most pivotal actor of the revolution, the *Liga Militar*. High-ranking majors, colonels, generals, and prominent politicians, most of them from Quito, quickly replaced the young officers who had spearheaded the revolt. Without the input of military men from all across the country who had helped overthrow president Córdova, the officers from Guayaquil and especially Quito, took over the government in the capital. No representatives from the provinces were present to install the new government, as the officers in charge there did not wait for their comrades from the provinces to arrive.

Like this, a Supreme Military Junta consisting of six officers named a Provisional Governing Committee made up of two generals and two civilians from Quito, one of which was Luis Napoleon Dillon. This committee sparked a resounding protest among the representatives from Guayaquil, principally because of Dillon's known fanatical animosity towards the bankers in the coastal city. Nevertheless, the protest did not do much to change the make-up of the new government, the Guayaquil representatives were given "lesser" appointments such as education and social welfare while Dillon's pack were in charge of the ministries of Interior, Foreign Affairs, War and Finance, which was headed by Dillon himself.

Like this, the first *Junta de Gobierno Provisional*, began ruling Ecuador on July 10, 1925. Considering the nature of the propaganda that preceded the coup, the new government decided to issue the arrest of the manager of the largest bank, Francisco Urbina Jado. In point of fact, the first provisional government would become synonymous with causing the demise of the coastal banking system, particularly with actions aimed at destroying Dillon's adversary, Urbina Jado and the Banco Comercial y Agrícola. An investigatory committee established on July 21, 1925, the *Primera Junta Fiscalizadora*, presented its findings concerning the practices of the Ecuadorian banks of issue to Luis Napoleon Dillon on August 22 of the same year. With the consent of the new minister of Finance, the report concluded that Urbina Jado's bank was guilty of circulating un-backed, and thus illegal, currency from 1914 to 1925.

This report, however, seems to have been the result of the post-revolution political warfare that was dictating all aspects of Ecuadorian politics during the time. As it happened, the committee adopted a very questionable definition of what constituted legal reserves and what comprised currency emission. In determining currency reserves, the report ignored the bank's gold holdings abroad, and government assets mortgaged to the bank, hence only considering gold actually deposited at the bank's vault in Guayaquil. The committee also considered all bank notes in circulation as well as all uncirculated bills resting at the bank's vaults. With these interpretations, the commission significantly increased the quantity of what were considered improperly backed bills because the new government considered that legal issues of currency had to be backed up by fifty percent gold reserves held locally. Within these parameters, the bank was guilty as charged. However, it is worth considering that with the inclusion of the bank's holdings abroad, and with the inclusion of government debt as part of its reserves as the legislation drafted in 1914 stipulated, the reserves of the Banco Comercial y Agrícola were always sufficient and frequently bettered the 50% requirement.

To make matters worse, the first provisional government, through Dillon's leadership, created a problematic currency shortage triggered by the increasing political and economic uncertainty that prompted citizens to stockpile legal bills. Plans to create the central bank by transferring undervalued bank reserves, resulted in the banks of issue restricting currency emissions and further fueling the nation's currency problems. Notwithstanding, with the report in hand, which also stated that the bank was solvent, Finance minister Luis Dillon fined the bank 2,237,093.33 sucres[76] and insisted that it be liquidated. Given the significance of the Banco Comercial y Agrícola, Dillon pressed the formation of a Central Bank in order to substitute the institution that had financed the country for over 25 years as both the leading bank of issue and as the government's most important lender. After all, it was the only plausible way that such a bank could be shut down.

The call for change that followed the revolution and Dillon's emphatic fight to liquidate the banking system, set up fitting conditions for the creation of a Central Bank, something Ecuadorians had long considered the establishment of as being of critical importance for the country's modernization. Certainly the coastal bankers themselves, as the actors most concerned with the nation's finances, had been discussing this effort since at least 1920. In point of fact, before the revolution, bankers had urged President Córdova in 1925 to invite Edwin Kemmerer to study the country and offer advice on currency stabilization and the creation of a central bank.[77] Nevertheless, Dillon and the first provisional government, although decided on establishing a central bank in Ecuador, had a different idea on how to go about it. They had no interest in paying a foreign advisor and instead proposed forming the central bank by confiscating the metallic reserves of the country's banks of issue by paying them half the world market value for their gold.[78]

Understandably, the coastal bankers became wary of this proposition that was to be executed by an extra-legal government and that would have destroyed their patrimony. They insisted that no action of this magnitude be enacted until a constitutional government was elected and a commission of experts offered their recommendations. The arguments that ensued quickly degenerated into a political battle between the coastal and sierra regions in which the local newspapers often favored the local viewpoints. The situation of the country was not getting any better and the public had no patience for any bickering. Discontent with the government, and disputes among the members of the Junta, forced the resignation of the provisional government, and appointed a second *Junta*

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[76] Rodriguez, *Government Finances and the Search for Public Policy*, 128.

[77] The coastal bankers offered to help with the financing of a Kemmerer advisory mission in 1925.

[78] Rodriguez, *Government Finances and the Search for Public Policy*, 129.

de Gobierno Provisional that would govern the country from January 10 through March 31, 1926.

The new government saw Dillon lose his post as finance minister, and new minister Humberto Albornoz would distance himself from the confrontational ways of his predecessor. In order to reach consensus, Albornoz hosted a banker's conference where the country's economic condition was to be discussed and solutions proposed. In this meeting, one of the main concerns was the government's hostility towards the banks, which had intensified the public's lack of confidence in financial institutions. In particular was the attack against the Banco Comercial y Agrícola because the bank issued the vast majority of currency then in circulation. And with the new definitions of reserve requirements, the recall of "illegal" bills, as other banks had done, would have resulted in the inability to conduct transactions, as the already present currency shortage would have worsened.

The solutions that were therefore proposed included the creation of a government office appended to the Ministry of Finance where currency backed by government assets, mortgage bonds, or a reduced metallic reserve could be issued. But mainly, the conference suggested the assistance of a foreign advisory mission to help with the nation's financial problems. The government's reaction was to reject most of the solutions proposed at the bankers' conference; however it did reopen the idea of negotiating with Edwin W. Kemmerer. When the Junta replaced the second provisional government with a single executive on April 1926, the process of bringing Kemmerer was finally concluded when the new head of government, former minister of Welfare, Isidro Ayora (1926-1931), reached an agreement with the Princeton economist.

Before Kemmerer would arrive in Ecuador on October 1926, the post-coup financial crisis got worse. The post-coup governments' actions had aggravated the situation through their policies against financial entities, so it was not long before the government was forced to take additional measures to try to save the country from crumbling further. On June 16, 1926, interim president Ayora[79] ordered the embargo of the metallic reserves of the banks of issue at a value less than half their actual market

[79] The final arbiter of Ecuadorian politics at the time, the Supreme Military Junta, opposed a premature return to a constitutional government. Thus Ayora ruled the country as interim president for 3 years.

price;[80] following this, on June 23, he established the *Caja Central de Emisión y Amortización* (Central fund of Issue and Redemption), which was authorized to issue currency with 25% metallic reserves as opposed to the 50% requirement specified for the former banks of issue. The new reserve created under the Caja provided backing for all bills in circulation as well as notes printed not in use.[81] The Caja further consolidated itself by transferring government indebtedness to banks towards the Caja and agreeing to amortize this debt with revenues from export duties.[82]

Four months after the Caja had taken over the Ecuadorian currency, Edwin Walter Kemmerer finally arrived in Guayaquil on the 18th of October 1926. He would find a nation that between August 1923, and July 1925, had expended two constitutional presidents, one acting president, a plural executive, and five ministers of finance, and from then on, a nation that had undergone a revolution that had ended in an authoritarian regime that had already positioned three provisional governments in 14 months. Unsurprisingly, he would also find a country with severe financial problems that included a faded export economy, currency shortage, lack of financial institutions, and the lowest rating for government bonds in all of Latin America.[83]

With a worldwide reputation as a foreign financial advisor, Kemmerer initiated his repute as a specialist in currency reform and central banking in 1903 as a member of the United States Philippines Commission. During his three-year stay in the Philippines, he drafted laws for implementing the agricultural bank of the islands, he placed the currency on the gold standard, and acted as chief of the division on currency. From then on, he would travel to countries all over the world and mimic the practices he had initiated in the Philippines. As Kemmerer historian, Paul Drake, notes, "hardly a word [of his proposals] … varied from Poland to Bolivia,"[84] thus the coastal bankers and the government understood what

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[80] Rodriguez, *Government Finances and the Search for Public Policy*, 132.

[81] Printed un-circulating bills had been included in the government's assessment regarding illegal currency of the issuing banks.

[82] This agreement violated the terms accorded with the Guayaquil-Quito Railway bondholders.

[83] Pineo, *Useful Strangers*, 1171.

[84] Quoted in Pineo, *Useful Strangers*, 1175.

a Kemmerer mission would recommend for Ecuador. Kemmerer, with a cost to the government of $70,000 plus all expenses (equivalent to over $930,000 in 2015), would recommend currency stabilization as well as devaluation, tax reform, a central bank in the capital and the modernization of the banking system as a whole, and naturally, the obligatory placement of the currency on the gold standard.

Once on Ecuadorian soil, the Kemmerer mission was greeted with hope and enthusiasm. The press, who had been divided just a few months back due to the discrepancies between the coastal bankers and the government, was now united in praise towards Kemmerer and his team. It was not uncommon to find newspapers with favorable biographical articles on all the people who integrated the mission. Articles with statistical information and suggestions to the mission were also widely printed in daily newspapers and other periodicals; interested citizens even sent letters with recommendations to the mission. The enthusiasm went as far as producing outright fallacy when newspapers in Quito, with alleged information from sources in New York, asserted that various Wall Street tycoons had decided on lending money to Ecuador and Bolivia because of the sole fact that they had hired the services of Edwin Kemmerer.[85] In truth, nothing could have been further from reality as Ecuador continued to struggle for credit consideration long after the mission left.

The mission followed a strict work schedule from the offices allotted to them in the recently inaugurated post office building in the center of Quito from which the final recommendations were submitted to the government on February and March of 1927.[86] The report consisted of over two thousand pages of proposed laws and reports on specific topics, all attached with the required explanatory statements. It was Kemmerer's practice to deliver drafts of laws ready to present to congress, and drafts of administrative decrees ready to be stamped by the executive as opposed to a single comprehensive report. This enabled the advisors to control the exact wording of the laws, thus eliminating the possibility of vague and confusing edicts that could have gone against his overall idea for the

[85] Paul Drake, *Kemmerer en los Andes* (Quito: Banco Central Del Ecuador, 1995), 229.

[86] The mission was unable to complete its work by the established date of February of 1927 because the Ecuadorian government requested the advisors for studies that had not been part of the initial agreement.

country. Although organized and efficient, the advisors were not always very careful. Vast sections of the report were simply borrowed from the work done in other countries. For instance, Robert Vorfeld, the expert in customs administration who had worked with the Tariff Commission in Washington, simply copied the work he had done in Paraguay. This resulted in unnecessary customs regulations to Ecuador's internal waterway traffic because in Paraguay, external commerce was transported through the international river that bears that country's name.[87]

Nonetheless, Ayora and the Ecuadorian people in general were quite pleased with the mission's work. Such was the case—or perhaps it was due to the fact that Colombia had started borrowing money from overseas banks almost immediately after putting its Kemmerer program in place—that the dictatorship expeditiously made into law the entirety of Kemmerer's recommendations. After all, Ecuador's economy was in dire straits and the government needed money quickly. The recommendations, as expected, sought to achieve "exchange stability, modern banking, fiscal order, more efficient customs administration, punctual debt payments, Anglo-Saxon commercial practices, and equal rights for foreign capitalists."[88] These goals were organized into two main objectives categories: the modernization and strengthening of Ecuadorian institutions and procedures, and the elimination of budget deficits. To accomplish the first, a new system for managing public funds and regulating the fiscal and banking systems was proposed. To accomplish the second, it was to be achieved through the centralization of government income, a new tax system, and through the implementation of a national budget over which government funds would be allotted.[89]

With his recommendations, Kemmerer employed a western orthodox economic thought of the time. His reports on tariff reform, contracts, and banking law closely resemble Woodrow Wilson's New Freedom policies in which the United States eased on free trade, severely punished unlawful business practices and initiated the federal reserve system. In point of fact, the mission's tariff reform was frequently criticized for its *laissez-faire* policies that Ecuadorians thought would condemn Ecuador to an agrarian collapse. Kemmerer, as he would always favor, also insisted on the gold

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[87] Drake, *Kemmerer en los Andes*, 257.

[88] Pineo, *Useful Strangers*, 1184.

[89] Rodriguez, *Government Finances and the Search for Public Policy*, 143.

standard even when Ecuador and many countries in Europe and America suspended convertibility due to the difficulties arising from the First World War. His approach went in accordance with Great Britain's Gold Bullion standard established in 1925 whereby currency was backed by gold, but in which gold would not exist in circulation. Even the focus on government spending in public works practiced by Herbert Hoover and later Franklin Roosevelt was taken into account when addressing Ecuador's public credit and public works development. At the time, the theory of under-consumption, which suggested that strong government spending on public works was necessary to restore the balance between production and consumption, was gaining momentum and Kemmerer seems to have included it within his suggestions.

The reforms thus addressed the problems that were perceived to be incapacitating Ecuador to achieve any sort of financial stability. The public works disorganization—which had been an integral part of the financial debacle that affected Ecuador when the cacao trade imploded, and when between 1914 and 1925 over twenty million dollars were spent with few tangible results—was changed so that those funds be diverted into servicing the country's foreign debt and strengthening public credit. Public works hereafter were to be funded by foreign loans or direct foreign investment, and be analyzed by a central comprehensive national planning program that would forbid Congress' practice of aimlessly appropriating funds for almost any program promoted by sectional interests.

Principal state institutions were created through new laws: the Central Bank of Ecuador, the Superintendence of Banks, the Comptroller General, and the Director General of Customs. Together these institutions brought about profound change in Ecuador, because even though many of the Kemmerer reforms would soon be forgotten, these institutions would continue to exist, and with great power. Immediately after their creation, for example, the Central Bank would place the country under the gold standard and define the discount rate. The superintendence of banks would begin regulating lending entities, and the comptroller General (*La Contraloría*) would begin monitoring government finances. The Director General of customs would, from 1925 to 1930, increase customs revenue from 19% to 25% of all imports,[90] consequently considerably increasing customs revenue for the central government (see table 13).

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[90] Drake, *Kemmerer en Los Andes*, 257.

Table 13: Customs revenue 1925-1947[91]

Year	Absolute amount (in sucres x 1000)	% of ordinary Government revenue
1925	20,284	55
1926	19,005	42
1927	23,277	36
1928	26,728	43
1929	27,806	43
1930	23,309	38
1931	17,496	39
1932	12,702	30
1933	12,582	30
1934	20,201	42
1935	29,118	44
1936	31,011	40
1937	30,161	34
1938	45,303	37
1939	35,571	30
1940	43,518	40
1941	38,709	36
1942	53,398	41
1943	67,501	40
1944	95,237	45
1945	90,203	36
1946	99,615	33
1947	152,626	39

Furthermore, some of the structural transformations promoted by the Kemmerer mission signified changes of a revolutionary nature because even though many of the propositions included in the 2000 page report were not new, the circumstances surrounding them were. 19 months after the Julian Revolution, Ecuadorians still had the sour memories that surrounded the uproar fresh in their minds. People were ready for change, and the press stimulated this openness through extensive coverage of the mission's reports. Journalists from media outlets throughout the country emphasized that the recommendations were not the product of partisan politics but the work of true independent scientists, and even supported the idea of foreigners directing the newly created institutions and procedures because it was believed no Ecuadorian had the expertise necessary to carry out the required

[91] Rodriguez, *Government Finances and the Search for Public Policy*, 188.

functions properly. Few newspapers remembered the less than desirable experience the nation had with another foreign advisor, John Hord, a few years prior. And so, when the Kemmerer mission departed to Bolivia in mid-March 1927, all but one of the newly appointed American administrators were already working at their posts.

Even when Ecuadorians expected better days after Kemmerer, many still felt the crisis affecting their everyday lives. Many believed regionalist politics would eventually thwart the implementation of the money doctor's reforms, especially if the country returned to constitutional government before they were carried through. Thus, on March 4, 1927, opponents of the Ayora administration attempted to overthrow the president and put General Gomez de la Torre as *Jefe Supremo* in his place. The attempt ended in failure, and Ayora used his position as dictator to quickly charge disgruntled bankers and his perceived adversaries as being responsible for the coup attempt. He then swiftly arrested them before anyone could challenge the accusations. Nevertheless, the propaganda used by the government against the conspirators, responsible or not as they may have been, strengthened the Ayora regime's political position, and attention was once again directed towards Kemmerer and the advice he would leave behind.

Depression

After the Kemmerer mission left Ecuador, the country hoped the reforms, which were immediately enacted almost to their entirety, would attract foreign investors and lines of credit. Unfortunately, even after improving procedures and creating new institutions, the money was not coming. Concerning this matter, Edwin Kemmerer warned the Ecuadorian people that they would need to be steadfast and patient, especially because the continuous default on loan payments across the nation's history had meant that Ecuadorian government bonds possessed a dreadful rating, the lowest in South America. As a matter of fact, at least for 72 out of the 97 years, from 1830 to 1927, the Ecuadorian government had constantly defaulted on loan payments. Further, he signaled that if and when Ecuador gained access to credit, these loans would come with high interest rates, and most probably request customs revenue as collateral.

It was also not helpful that the country had undergone a revolution in 1925 and subsequently produced three unconstitutional governments. Regarding this, the United States refused to recognize any of these extra-legal administrations, and thereby further hampering the Ecuadorian hope for foreign capital. It was not even enough that Kemmerer himself tried to persuade bankers and government officials that Ecuador, having enacted his reforms, was worthy of diplomatic acknowledgement and financial backing. Kemmerer went as far as saying in 1927 to the United States Department of State, that Ecuador, now probably had the most honest government in its history and that the United States should find some way to recognize it as soon as possible.

Kemmerer's insistence was further fueled when he informed the Department of State that, after his conversations with North American leading bankers, diplomatic recognition of Ecuador would reinforce their intentions to grant financing to the country. It had been the bankers' opinion that the management of the customs office satisfied the conditions they were looking for to grant any potential loan because now they could reliably be guaranteed by customs revenue. Yet at the same time, the United States government was receiving pressure from the long-standing and unattended bondholders, whose bonds had been issued during the construction of the Ecuadorian railroad. They insisted no recognition be granted until they were reimbursed. To this, the money doctor pointed out the unsolvable dilemma of the Ecuadorian problem. He exposed the fact that payment to the existing bondholders could not be carried out until the country received financial backing, which was in turn conditioned on the United States government recognizing the Ecuadorian. He further expressed his opinion that any real possibility of bondholders getting their money was not with a Latin American congress, as it would never approve a reasonable liquidation, but with a progressive dictatorship like that of Ayora. So, it was not until August 1928, when an election for a new National Assembly was announced, that the United States finally granted *de jure* recognition to Ecuador.[92]

Nevertheless, given the absence of a legal requisite that would have mandated the United States' Department of State to approve foreign lending, Kemmerer insisted that lenders take Ecuador into consideration. Such was the case, that in early 1928, Kemmerer helped the Ayora government convince the Dillon, Read & Company, as well as other corporations, to facilitate financing. These negotiations produced the visit from former Kemmerer mission general secretary, Edward Freely, to Quito and discuss loan terms with Ecuadorian officials. This visit only produced

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[92] Drake, *Kemmerer en los Andes*, 259.

negative reactions from both governments. The United States government was furious, not only at the fact that Ecuador was being considered for North American financing when its government wasn't even recognized yet, but also because congress was entertaining the idea of cancelling the North American functionaries' contracts. In Ecuador, the visit was seen as blackmail by the United States government, as it was believed that Ecuador was being pressured into signing a high-interest loan just so that the country could receive diplomatic recognition.

Thus the hopes for foreign capital did not materialize. While the rest of Latin America was offered plenty of money, taking in the 1920s more loans than at any time until the 1970s,[93] Ecuador would have to accept a different situation. In the end, the only foreign loan Ecuador would receive during the 1920's came in the immediate aftermath of the Kemmerer mission when on November 1927, the Swedish Match Company advanced 8 million sucres to the government in exchange for a 25-year monopoly to import and produce matches in Ecuador. The Ecuadorian government would use these resources to fund the *Banco Hipotecario del Ecuador* in 1928 with the aim of helping local farmers.

Ecuador's struggles for financing were accompanied by an effort to restore constitutional rule, which put in place the constitution of 1929 with Isidro Ayora as constitutional president. This *magna carta* attempted to constitute Ecuador within a parliamentary organization. Essentially, this implied that any legislator could individually challenge any minister of state and ask for their denunciation, or request a motion of no confidence. This resulted in the legislative branch turning into a mob-like institution where appointments would be negotiated and imposed on the president. With this constitution, the president was effectively stripped of the powers he was used to having; this being especially true with Isidro Ayora and his three-year dictatorship.

Following the change of country charter, which included the prearrangement that foreign functionaries were no longer permissible, Ecuador would deviate from the procedures that had been put in place by the Kemmerer mission. In point of fact, the departure by Ecuadorian institutions from what the mission had envisioned, was already acknowledged in 1929 by the departing foreign functionaries. As

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[93] Pineo, *Useful Strangers,* 1189.

Kemmerer mission member Tompkins proclaimed to the Ecuadorian National Assembly that same year:

> While the Kemmerer Mission does not need any defense, however, if judged only by its results, it could be affirmed that its visit to Ecuador was a complete fiasco. It really was, but not because of the mission itself… In light of subsequent events, it is clear that the whole issue of taking the services of the Kemmerer mission and its various consultants was merely a beautiful gesture. One objective was, of course, to influence public opinion within the country. The other objective, and most important, was directed to create favorable propaganda abroad and get a loan.[94]

The deviation from what had been spawned by the Kemmerer mission would become a risky proposition for Ecuador. The first years of the Ayora administration had been accompanied by a favorable export market and by the Kemmerer reforms, which produced favorable financial outcomes. When Kemmerer's recommendations ceased to be followed, spearheaded by the decrease in executive power as a result of the new constitution of 1929, the country was able to maintain relative stability because of the then still-unwavering export market. From 1925 to 1928, Ecuador maintained a favorable trade balance mainly due to the still-relevant cacao trade, which still represented 38.5% and 30.1% of total exports in 1927 and 1928 respectively (see table 14). Also important, was Ecuador's somewhat diversification in export products, nearly every other product increased its percentage rate of total exports with relation to 1925 (see table 15). Consequently, from 1926 to 1929, customs revenue as a percentage of national government income was always over a sustaining 43% (see table 16).[95]

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[94] Drake, *Kemmerer en los Andes*, 267.

[95] In 1927 government income from currency revaluation caused customs percentage to fall to 36%. However, if government revenue from this source is excluded, customs revenue was 45% of income that year.

Table 14: Cacao exports 1925-1947[96]

Year	Kg x 1000	Value in Sucres x 1000	% of total exports
1925	32,281	33,986	46.7
1926	20,567	26,436	41.6
1927	22,238	36,908	38.5
1928	23,737	29,653	30.1
1929	16,386	21,256	24.7
1930	19,184	23,403	29.0
1931	13,839	12,254	21.6
1932	14,419	11,267	22.9
1933	11,004	8,720	19.7
1934	16,143	27,165	25.0
1935	19,701	23,828	21.0
1936	17,114	31,472	21.6
1937	20,652	49,985	30.5
1938	16,882	39,276	36.6
1939	13,276	37,033	22.1
1940	11,208	29,354	17.5
1941	14,433	34,364	17.2
1942	13,761	40,326	13.5
1943	16,827	51,793	13.2
1944	15,750	41,985	9.0
1945	16,827	53,547	14.2
1946	16,526	74,934	15.8
1947	19,757	189,038	32.8

Table 15: Selected exports by percent value of total exports 1925-1930[97]

Year	Coffee	Rice	Panama Hats	Crude Oil
1925	10.5	0.2	4.4	0.6
1926	18.1	0.5	8.7	3.5
1927	10.0	1.1	6.1	5.6
1928	17.6	2.9	4.6	12.3
1929	13.6	4.9	7.9	17.7
1930	9.4	4.6	10.4	21.4

[96] Rodriguez, *Government Finances and the Search for Public Policy*, 192.

[97] Rodriguez, *Government Finances and the Search for Public Policy*, 180-181.

Table 16: Customs revenue as a percentage of national government income 1925-1947[98]

Year	Absolute Amount x 1000	% of income
1925	20,284	55
1926	19,005	42
1927	23,277	45 (36 with currency revaluation)
1928	26,728	43
1929	27,806	43
1930	23,309	38
1931	17,496	39
1932	12,702	30
1933	12,582	30
1934	20,201	42
1935	29,118	44
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1946	99,615	33
1947	152,626	39

Nevertheless, the Ecuadorian economy, and therefore its steadiness as a nation, hung by a thread towards the end of the 1920s. The Wall Street Crash of 1929, perhaps the most devastating stock market crash in the history of the United States, signaled the beginning of the Great Depression in that nation, which affected virtually all Western economic powers and their connected economies. Ecuador, having the North Americans as its most important economic partner, would too feel the effects of the worldwide financial catastrophe in its totality. In 1929, 47% of Ecuador's exports were to the United States; similarly, 41% of all Ecuadorian imports came from the North American nation. After the implosion of cacao, what remained of Ecuador's export economy collapsed. Ecuadorian exports fell by two-thirds from 1928 to 1932, similarly all imports contracted by a factor of 64.7% during the same

[98] Rodriguez, *Government Finances and the Search for Public Policy,* 188.

period.[99] Consequently, after 1929 (see table 16), customs revenue as a percentage of national government income receded continuously and government income as a whole suffered as a result (see table 17).

Table 17: National government income 1925-1946[100]

Year	Absolute amount x 1000, in sucres	Year	Absolute amount x 1000, in sucres
1925	36,816	1926	44,856
1927	65,150	1928	61,576
1929	64,480	1930	60,821
1931	45,270	1932	42,162
1933	41,842	1934	48,242
1935	66,486	1936	77,464
1937	86,585	1938	120,833
1939	117,187	1940	108,553
1941	109,001	1942	128,985
1943	168,284	1944	211,958
1945	252,717	1946	298,813

Government income was precipitously diminishing, which resulted in a government budget fiasco. From 1930 to 1938 the government experienced continuous deficits (see table 18), even when bank loans were considered part of government revenue, and even with the revaluation of gold reserves in 1935. This undoubtedly instilled greater pressure on the governments that ruled Ecuador in the 1930s. Ayora was the one who experienced the offset of the worldwide depression, and the problems with the state budget were accompanied by an ever-increasing cost of living for Ecuadorians as most of the products of basic necessity were on a steady cost increment in relation to wages (see table 19). Henceforward, even though large parts of the Ecuadorian population at the time lived in rural areas and therefore could not experience the effects of depression as much as the urban population did, the restlessness of the Ecuadorian people grew.

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[99] Pineo, *Useful Strangers*, 1206.

[100] Rodriguez, *Government Finances and the Search for Public Policy*, 219.

Table 18: Projected vs actual government income, 1925-1940[101]

Year	Budgeted Income (thousands of sucres)	Actual Income (thousands of sucres)	Surfeit/Deficit
1925	35,833	36,816	983
1926	41,988	44,856	2,868
1927	41,988	75,211	33,223
1928	51,588	74,866	23,278
1929	59,900	64,480	4,580
1930	64,037	60,821	(3,216)
1931	61,476	45,270	(16,206)
1932	49,115	42,162	(6,953)
1933	49,220	41,842	(7,378)
1934	48,970	48,242	(728)
1935	48,970	66,486[102]	17,516
1936	80,100	77,464	(2,636)
1937	79,500	86,585	7,085
1938	120,500	120,833	333
1939	130,950	117,187	(13,763)
1940	113,050	108,533	(4,517

Table 19: Price index for basic necessity goods, 1925-1943[103]

Year	Index	Year	Index
1925	145.4	1926	182.3
1927	169.7	1928	138.9
1929	144.3	1930	143.3
1931	106.4	1932	100.09
1933	134.5	1934	185.6
1935	180.5	1936	220.3
1937	264.1	1938	255.7
1939	256.9	1940	262.4
1941	284.8	1942	370.8
1943	427.6		

Social dissatisfaction began in 1930 with student revolts and a coup attempt led by General Francisco Gómez de la Torre. In the same manner,

[101] Rodriguez, *Government Finances and the Search for Public Policy*, 229.

[102] Includes income from the revaluation of gold reserves.

[103] Rodriguez, *Government Finances and the Search for Public Policy*, 171.

indigenous uprisings struck Ecuador in 1931, like those of *Quito Corral* and *Tanilagua*; *Palmira* and *Pastocalle* in 1932; *Mochapata* in 1933; and *Rumipamba*, *Llacta Urco* and *Salinas* in 1934.[104] Discontent was ever-present; the uprising by military sappers from Chimborazo, followed by a mob in Quito who went up in arms demanding undeliverable relief measures, resulted in the forced resignation of President Ayora on August 24, 1931. Pressured by a faction of the military who wanted colonel Luis Larrea Alba in power, Ayora appointed him as secretary of state so that he would, as the constitution established, assume the presidency after his resignation.

Larrea held office for less than two months. He believed that congress had to grant him extraordinary powers so that he could resolve the problems facing the nation. When congress refused, with the consent of the military, he decided to abolish it. This action provoked an enraged outcry by the citizenry, which resulted in the death of 10 people, with other dozens injured.[104] Following this despicable incident, Larrea resigned, and president of the senate and former president of Ecuador, Alfredo Baquerizo Moreno, took office on October 15, 1931. As his first executive order, he convened presidential elections to be held on October 20 and 21. With 48% of the 54,320 votes counted, former president of the Central Bank of Ecuador, Neptalí Bonifaz, was elected president due to overwhelming support in the sierra region (see table 20).

Table 20: Election of 1931[105]

Candidate	Votes	Percent of votes
Neptalí Bonifaz Ascázubi	26,062	48
Modesto Larrea Jijón	15,630	28.8
Ildefonso Mendoza Vera	12,628	23.2
Total	54,320	100.0

The president-elect would never serve. Widespread discontent, which included frequent bungled revolts, exacerbated the nation's problems. The financial devastation was accompanied by a full-swing political and social meltdown. The 1931 election aimed at restoring constitutional government by instating the third government since the resignation of

[104] Academia Nacional De Historia Militar, comp., *Historia militar del Ecuador*, 432.

[105] Rodriguez, *Government Finances and the Search for Public Policy*, 165.

Ayora two months prior. However, this would not happen. Ecuador was divided; every section of the country was clashing, liberals and conservatives, serranos and costeños. Worsening things was the fact that the constitution of 1929 stipulated that the final vote count of the elections was to be done by the following legislature meeting, which was to take place on August 1932, a full 10 months away. This left plenty of time for things to take a turn for the worse.

On January 1932, liberal loyalists to Larrea Jijón attacked the military barracks in Tulcán, in northern Ecuador, only to end in failure. Three months later, in April, military commander Mendoza led the Ecuadorian navy into revolt only to be defeated too. The following month, university students took to the streets in protest only to be disbanded by a garrote-armed coalition of *Bonifacistas*[106] and the police. The continuous social and political unrest did not cease to be accompanied by the continuous financial catastrophe. The assurances of government officials and foreign experts that the country would be able to successfully weather out the depression did not convince the Ecuadorian people. They continued to make unattainable demands for relief; they insisted the government introduce tariff measures that would raise agricultural and industrial production. To these demands the government yielded, and in retrospect they committed a terrible mistake in doing so.

The procedures instilled by the Kemmerer mission that had proven fruitful for over a quarter decade had long been abandoned in the 1930s. After President Ayora left office, any hopes of carrying the Kemmerer reforms through were gone. In its place, the Ecuadorian governments experimented with an array of measures that hoped would improve economic conditions. The government attempted to control trade through the implementation of protectionist and preferential tariffs, exchange controls, restrictions on imports, payments in nonconvertible currencies, and special bilateral agreements. Mind-bogglingly, customs revenue was all but eliminated through the placement of additional tariff charges that severely hampered customs transactions. The *aduana*[107] as a source of revenue was abandoned in favor of crackpot protectionist policies.

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[106] Bonifaz loyals.

[107] Customs house.

As an export economy, it was inconceivable that such actions took place in Ecuador. Authorities even tried to find a niche in the spirits market in the United States. In 1933, the end of prohibition in the northern nation made many Ecuadorians reason that the economy could get a boost by exporting locally produced *aguardiente*.[108] But consumers in the United States had little interest in aguardiente, Ecuadorian or otherwise. Yet perhaps most troubling of all the effects of the doomed government experimentation during the worldwide depression, was the uncertainty among the economically active community. Governments lasted months, while ministers would be replaced within weeks. Policies, tariffs and taxes changed at similar rates. The uncertainty this instability instilled in investors and entrepreneurs effectively killed any possibility of new capital entering the suffering Ecuadorian economy. The government's efforts unequivocally failed and injured rather than aided Ecuador's economic recovery in the 1930s.

With customs revenue falling, diminishing over 30% from 1929 to 1932 with respect to its share of government income (table 16), the government had to resort to the central bank for help. Just as governments had done in the 1920s, governments in the 1930s ran to the banks in order to try and finance their regimes; not much was learned, little had changed. What did change was the fact the in the 1930s, the lender became the Central Bank. This institution's conservative policies could not offset the depletion of the country's gold reserves or the contraction of the money supply. In 1927, the year the bank was founded, Ecuador possessed 44,085,490 sucres in metallic reserves. Within the next few years, however, Ecuador would sell more gold than it purchased every year until the country went off the gold standard in February 1932. The gold drain was so extreme that when inconvertibility went into effect, the nation possessed 17,408,986 sucres in metallic reserves (see table 21), a 60.5% decrease from 1927. By the end of the decade, grams of gold reserves would decrease by 75.3%.

[108] Anise-flavored spirit distilled from sugar cane.

Table 21: Central Bank of Ecuador gold reserves, 1927-1939[109]

Year	Amount in sucres[110]	Grams of Gold
1927	44,085,490	13,266,779
1928	38,029,255	11,449,990
1929	35,063,646	10,557,440
1930	28,639,062	8,618,439
1931	15,492,532	4,662,214
1932	17,408,986	5,088,230
1933	18,340,216	5,327,337
1934	27,156,303	5,846,330
1935	38,830,834	3,862,192
1936	42,525,686	3,643,202
1937	39,890,498	3,386,173
1938	39,798,376	3,216,639
1939	40,857,151	3,271,275

The depleting gold reserves came in conjunction with the contraction of the money supply. In 1931, the monetary circulation was less than half of what it had been in 1927 (see table 22). The effect of this contraction was felt by the Ecuadorian people, and again instilled pressure on the government to take action. The public diagnosis was that the retrenchment of the money supply was the cause, not the result, of the financial crisis. Thus, pressure was put forth on the government to increase currency emission as well as to reclaim funds earmarked for debt service in order to meet domestic needs. If the depleting gold reserves, the contraction of the money supply, and continuous government experimentation with financial policy were not enough, on the same day the gold standard was repealed, the president signed a decree obliging the Central Bank to lend the government fifteen million sucres for public works projects, agricultural credit, and for servicing public debt.

[109] Rodriguez, *Government Finances and the Search for Public Policy*, 168.

[110] Gold reserves were revaluated twice, first on December 18, 1935 when price changed from 3.3229 sucres per gram of gold to 9.968331 sucres; and then on June 13, 1936 when the price of gold was established at 11.6466 sucres per gram.

Table 22: Monetary circulation, 1927-1946[111]

Year	Amount	Year	Amount
1927	38.7	1937	68.1
1928	36.5	1938	73.1
1929	30.0	1939	77.9
1930	23.5	1940	80.2
1931	19.1	1941	120.2
1932	30.3	1942	169.3
1933	43.1	1943	232.2
1934	56.7	1944	294.6
1935	59.9	1945	321.2
1936	67.1	1946	349.7

The decree started a negative borrowing spiral resembling that of the previous decade. Between March 1932 and August 1937, the Ecuadorian government borrowed 47 million sucres from the Central Bank.[111] These funds were mostly used to cover budget deficits, fund public works projects, finance military expenditures, and to pay off the government's debt to the Banco Hipotecario in order for it to expand agricultural credit. Increased borrowing and increasing currency emission unleashed a ferocious and unforgiving inflation rate. From 1928 to 1938, the exchange rate increased from 5 sucres per U.S. dollar to 14.13 sucres per dollar, a 182.6% hike within a decade.

Financial tribulations were intrinsically connected to the cataclysmic conglomerate of ruin the country was in. The constant protests and public demands intensified in 1932 when an organized mob called the *Compactación Obrera* (workers' compaction) prepared daily incursions of street manifestations in the capital in support of Neptalí Bonifaz. As tensions increased, congress finally convened in August of 1932. However, congress did not validate the election from 1931 as had been expected. Rather it confirmed rumors that Bonifaz was to be disqualified as president-elect.

Born in Ecuador, Bonifaz was the son of a Peruvian diplomat, and although his mother was Ecuadorian, and even though he was an Ecuadorian for all practical purposes, he had held a Peruvian passport; as he put it, it was a "negligence of youth."[112] So, on the evening of August

[111] Rodriguez, *Government Finances and the Search for Public Policy,* 169.

[112] Dobronski, *El Ecuador: Los hechos más importantes de su historia,* 292.

20, 1932, after 10 days of futile negotiations between congress and Bonifaz, the legislature disqualified his candidacy and all hell broke loose. Seven days later, on August 27, 1932, the Compactación Obrera, otherwise known as the *Compactados*, with the support of several military battalions went up in arms against forces supporting congress. This resulted in *La Guerra de los Cuatro Días* (the Four Days' War), a bloody fratricidal conflict that took the lives of thousands of Ecuadorians. During this time of war, president Baquerizo Moreno, forced to resign by the nation's circumstances, did so on August 28th while naming Carlos Freile Larrea as Minister of State so that he could assume power after his resignation, as dictated by the constitution.

Three days later Ecuador was in a state of anarchy. There was no seated government as on September 1st, Freile Larrea resigned along with his war minister in order to follow a constitutional precept that stipulated that the new president was to take office that day, or new elections be convened (elections implied that responsibility lay with the head of congress). Nevertheless, an accord was finally reached around 7pm when Neptalí Bonifaz surrendered and retreated to his family hacienda. Alberto Guerrero Martinez, as the last president of the senate, assumed the office of president on September 2, the following day.

Three months later, Juan de Dios Martinez assumed the presidency. Only 10 months later he was deposed amidst worsening financial circumstances. Many politicians desired Ecuador go to war by entering the conflict of Leticia[113] between Colombia and Peru. When Martinez refused, congress issued a vote of distrust with the pretext that he was unable to adequately carry out the international businesses of the country. Two attempts to reconstitute the country, and ten other Ecuadorian heads of state (five acting presidents, two elected presidents, two supreme chiefs, and one interim president) would follow Juan de Dios Martinez during the difficult time of 1930s Ecuador. Then on September 1, 1940, Carlos Alberto Arroyo del Río would assume the presidency and serve the first complete term since José Luis Tamayo, who had served as president from 1920 through 1924.

[113] Armed conflict between Colombia and Peru that lasted from September 1, 1932, to May 24, 1933.

War

On July 17, 1936, the *pronunciamiento*[114] marked the start of the Spanish Civil War, marking the beginning of lasting conflict in Europe. Officially, the Second World War would come under way in 1939 after the Nazi invasion of Poland on September 1st. In Ecuador, armed conflict would begin almost two years later, on July 1941.

The economic and political context Ecuador had endured since the fall of the cacao trade, had assured the country be unable to effectively respond to foreign policy challenges and defend their national interests. This was painfully evidenced when Ecuador forfeited the legitimate and long-standing territorial claims of Amazonian territory to both Colombia and Peru as those nations battled for disputed ground, which included these Ecuadorian claims. Ecuador never entered into conflict, as it felt betrayed by Colombia when it had relinquished territories that had been Ecuadorian to Peru. Lacking the military might to square off against either Colombia or Peru, Ecuador remained neutral and acquiesced.

From September 1, 1932, to May 24, 1933, Colombia and Peru engaged in an armed conflict after Peru invaded the territory of Leticia. Peru was unsatisfied with the terms of the peace agreement, the Salomón-Lozano Treaty, reached 10 years prior and had thus decided to claim by force what they thought should be theirs. The incident was settled by the Rio de Janeiro Protocol of 1933, which ratified the Salomón-Lozano Treaty of 1922. Following the conflict with Colombia, in 1936, the Peruvian army, wanting to overturn their military discomfitures, advanced their military posts in the Amazon towards Ecuador. Pressured by this advance, and with a nonexistent military force, Ecuador signed the Ulloa-Viteri Accord, which set up a status quo line invented by Peru based on the effective possession of territory that each country had in the region at the time. In this accord, historical borders were virtually ignored and instead were the Peruvian military posts that determined country borders.

Meanwhile, Ecuador's financial troubles were aggravating all corners of the nation's problems. The incessant changes of heads of state resulted in a severely deficient diplomacy that, among other instances of negligence, had forgotten to join the League of Nations, and in September

[114] Coup d'état proclaimed by a group of generals under the leadership of Spanish General José Sanjurjo against the elected government of the Second Spanish Republic.

1936 requested to directly negotiate with Peru the border disputes. This decision detached the mediation of the United States and left Ecuador alone to deal with its aggressive southern neighbor. By 1938, Ecuadorian president Manuel María Borrero requested the mediation of Argentina, Brazil, Chile, the United States, and Uruguay, to find a solution to the growing tensions of the border dispute. The request was rejected by Peru and any solution became moot.

What Ecuador desired most was access to the Marañón River. This wide and very navigable tributary of the Amazon meant Ecuador would assure access to both oceans. To this point, Ecuador was resolute. The country had already conceded too much of its territory throughout its 110-year history, principally to Brazil in 1904, Colombia in 1916; and to both Colombia and Peru in 1922 and again in 1933 when both countries negotiated the territories rightfully claimed by Ecuador. Peru, on the other hand, wanted vindication. Ecuador's southern neighbor had lost its territorial disputes to Chile in the War of the Pacific (1879-1883), and to Colombia in the conflict of Leticia. It wanted to redeem national pride through a profitable resolution with unstable Ecuador.

Peru's plan seems to have initiated at least since 1931, in preparation to fight with Colombia. From 1931 to 1941, Peru more than doubled its army, from 8,000 to 16,705 soldiers, and purchased fighters, bombers, and navy destroyers.[115] Further, it hosted a military mission from fascist Italy that lasted from 1937 to 1941, and continuous military cooperation with Japan during all the 1930s. Conversely, Ecuador did almost nothing to respond to Peru's army build-up and mobilizations (See supplement 1). The nation's severe financial and political problems during the 1930s meant that war with Peru was not at the forefront of the nation's to-do list. Ecuador held the belief that diplomacy would be the vehicle to solve the disputes with its southern neighbor and was thus unable to militarily respond to the Peruvian transgressions.

Ecuador was not prepared for war. During the hostilities between Colombia and Peru, the Ecuadorian budget was barely over 49 million sucres, and actual revenue under 42 million (See table 18). The cost to properly arm 20,000 men in 1933 was 25 million sucres, and the cost to finance them for six months exceeded 40 million. Towards the end of the decade, the situation had not changed much. Ecuador was still struggling

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[115] Pineo, *Useful Strangers,* 1321.

financially as well as politically, and the nation's military was equally in distress. In 1940, the totality of Ecuador's reserves was 67,140,000 sucres, and even with two extraordinary budgets approved by congress that same year, the nation's budget never surpassed 122 million sucres ($7,261,904.76 with an exchange rate of 16.80 sucres per U.S. dollar). The military budgets were appalling, and in fact decreased from 1939 to 1941 (see table 23). The export-dependent economy suffered at the wake of the fighting in Europe and thus Ecuador was unable to effectively increase funds.

Table 23: Ecuador military budgets, 1939-1941[116]

Year	Amount in sucres
1939	29,414,044
1940	26,740,000
1941	24,676,930

By 1940, the war in Europe was the focus. As Winston Churchill replaced Neville Chamberlain as Prime Minister of the United Kingdom, Peruvian troops were advancing towards Ecuadorian territory. As Churchill delivered his famous "blood, toil, tears and sweat" speech, Peru was actively recruiting troops. Blood, toil, tears and sweat is what awaited Ecuador as they inexplicably diminished their military budget in November 1940 and 1941. On January 1941, Ecuador unsuccessfully requested that Peruvian troops withdraw. By February, the Peruvian invasion seemed imminent as they continued to advance with the pretext that Ecuador was mobilizing its own troops towards the Peruvian territory of Zarumilla. Three months later, Peru pressured the withdrawal of the mediation that had been offered by Argentina, Brazil, and the United States, as well as rejected the joint letter issued by the same countries urging an end to the dispute (Ecuador had immediately accepted both the mediation and the letter). Then, on July 5, 1941, with the pretext of protecting Peruvian farmers, hostilities broke out.

Peru, in fact, wanted war. Given the American continent's preoccupation with aggression from the Axis powers, Peruvian officials determined the time was right to invade. As Peruvian farmers crossed into Ecuadorian territory, border patrols began exchanging shots. The

[116]Academia Nacional De Historia Militar, comp., *Historia militar del Ecuador,* 444.

following day, Peru would launch an artillery attack and send over its bombers. The three-week war was a very uneven one. Peru's population was over twice as large as Ecuador's, Peru's national budget was over four times as large, and Peru's military budget was twelve times as large as Ecuador's. Peru invaded with over 13,000 troops while Ecuador defended with less than 2,000 ill-equipped soldiers.[117]

On July 22, Peru overturned Ecuadorian garrisons to advance into the province of El Oro. By July 26, Peruvian forces, aided by newly acquired Italian fighters and U.S. bombers, were reaching the Ecuadorian cities of Machala and Puerto Bolivar. In Guayaquil, Ecuadorian forces mutinied while in the occupied provinces the local population did nothing to resist the invaders. Ecuador's best fighting force, the *Cuerpo de Carabineros* (Rifle Corps) never made it to the border, as president Arroyo del Río kept them in Quito apparently in order to safeguard his unpopular regime. In point of fact, the Peruvian army did not really fight the Ecuadorian as such, but rather faint detachments of it since the bulk of the regular military remained in garrison throughout the country. Thus, by the end of July 1941, the Peruvian forces were decidedly imposing their strength on Ecuadorian soil while the Ecuadorian military cleared from the battlefield in defeat and openly disserting. Peru would suffer one hundred casualties from the war, but at least five hundred Ecuadorians died in battle.[118]

On July 26, 1941, Ecuador and Peru agreed to a cease-fire, although Peruvian forces continued their advance. In fact, Peruvian General and commander of the Peruvian armed forces, Eloy Ureta, pressured Lima for permission to advance all the way to Guayaquil. By August 2, the mediating nations advised a troop withdrawal, which Peru did not respond to. Ecuador accepted immediately. By September 15, Peru had occupied over 1000 square kilometers of Ecuadorian territory and demanded Ecuador immediately relinquish them control of it. Ecuador proposed an armistice, which Peru finally accepted on October 2, 1941. The following December, the mediating nations proposed a withdrawal of troops to the 1936 borderline, which again Ecuador agreed to immediately while Peru refused.

On January 1942, the Third Consultative Meeting of the Ministers of Foreign Affairs of the American Republics met in Rio de Janeiro. After the

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[117] Pineo, *Useful Strangers*, 1339.

[118] Pineo, *Useful Strangers*, 1348.

Empire of Japan bombed Pearl Harbor on December 7, 1941, the United States had insistently called for the Rio de Janeiro conference in order to line up Latin American support for the allied war effort. In the meetings, Ecuador sought to have the Peruvian invasion treated as well, however, the U.S.-led conference considered the Ecuador-Peru war as a distraction given the much more pressing matters concerning the Axis powers. In fact, the Peruvians took this to their advantage, as they knew the United States would not come to the aid of Ecuador with fighting going on in Europe. In fact, Peru now demanded territories that had clearly been Ecuadorian, plus reparations.

Moreover, important financial interests within the disputed territory accompanied the snub to Ecuador's plight at the U.S.-led conference. In 1937, the Ecuadorian government had granted use of oil-rich lands to the Anglo Saxon Petroleum Company, a subsidiary of Royal Dutch Shell. Likewise, the Peruvian government had granted territories with presumed rich oil reserves to North American companies. This fact cannot be overlooked when analyzing the behavior of the United States in addressing the Ecuador-Peru conflict. With the Netherlands being occupied by Nazi Germany, Shell was now considered to be serving German interests and thus Allied efforts included diminishing the potential for oil exploitation in the "German" controlled Ecuadorian jungle. Likewise, the United States would have wanted to protect its own interests by having Peru gain more land because North American oil companies had agreements with the Peruvian government to make use of the perceived oil in those territories.[119] Further still, the United States was desperate to decrease Nazi presence in Latin America. From 1929 to 1936, German imports rose from 12% to 21% of Ecuador's total, with the U.S. falling from 40 to 27%.[120]

Meanwhile Peru, having ignored every petition to retreat, was still occupying Ecuadorian territory. Furthermore, it had given Ecuador a six-month deadline to surrender to their demands or face the consequences. Given the circumstances, the Ecuadorian government had no choice but to concede, if it did not, Peru would have probably pressed its military advantage to invade more territory. U.S. officials had no intent on

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[119] Jorge Villacres Moscoso, *Problemas económicos y políticos del Ecuador*, vol. 1 (Guayaquil: ESPOL, 1978), 113.

[120] Pineo, *Useful Strangers*, 1405.

interfering and were focused on having this conflict end so that the continent could stand united against Axis aggression. Ecuador's efforts to get U.S. backing were futile. The nation's leading diplomatic representatives were sent to Washington and relations with the Axis powers broken, yet the United States would not entertain the Ecuadorian plight. In point of fact, the United States never tried to make a case against the Peruvian aggression even when Peru blatantly violated the cease-fire agreement, and damaged U.S. property through their aerial bombings. The official position of the United States to not endorse the seizing of territory by force of arms was forgotten, and Ecuador was left alone and defeated.

The shamelessly named *Protoclo de Paz, Amistad, y Límites* (Protocol of Peace, Friendship and Boundaries) was signed by Ecuadorian Foreign Minister Julio Tobar Donoso on January 29, 1942 in Rio de Janeiro with Argentina, Brazil, Chile, and the United States as guarantors. The treaty was a terrible deal for Ecuador; it forced the country to relinquish all territorial claims in the Amazon, claims that had been in existence since independence from Spain. Additionally, it relinquished over 200,000 square kilometers of territory to Peru, almost half the area of the entire country.[121] The treaty was ratified by Peru on February 26, 1942, fifteen days after it had started its retreat from occupied Ecuador. Ecuador followed; ratifying the protocol on February 27, 1942, after the senate had approved it four days earlier with 26 votes in favor, 3 against and 5 abstentions.

Nine months later, on November 1942, Franklin Delano Roosevelt tried to make amends by inviting Arroyo del Río to Washington (he had done the same with the Peruvian president in May). When he arrived, both Roosevelt and vice-president Henry Wallace greeted him at the airport and honored him with a banquet at the White House. He was then granted the opportunity to address Congress, and later received honorary degrees from Columbia and George Washington University. Nevertheless, the damage was done and most Ecuadorians felt betrayed even when a generous local press celebrated the president's trip, which had been a first of its kind for a sitting Ecuadorian head of state. Trips to Colombia, Cuba, Mexico, Panama and Venezuela were also carried out that year.

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[121] Total area of Ecuador as of 1998 is 275,830 square kilometers.

For two years following his visit to the United States, Arroyo del Río held a grip on power using force on all political opponents, real or imagined as these may have been. His trustworthy battalion of Carabineros managed to suppress several uprisings during this time, including an armed assault on the presidential palace on May 1943. However, by 1944, growing discontent was further fueled when, as election time approached, Arroyo del Río faithful Miguel Angel Albornoz was handpicked to be the president's successor. This resulted in a massive opposition movement called the *Alianza Democrática Ecuatoriana* with former president Velasco Ibarra (1934-1935, 1944-1947, 1952-1956, 1960-1961, 1968-1972), who was exiled in Chile, as the sole opposing candidate. When Arroyo del Río tried to forbid Velasco's return to Ecuador, and bizarrely cede more territory (the island of Matapalo) to Peru, public clamor for action continued to increase. Then on May 28, 1944, factions of the military in Guayaquil staged a successful uprising that quickly spread throughout the country with the support of thousands of people. After lamentable fighting, which resulted in the death of many Ecuadorians, Arroyo del Río resigned and fled to the United States in disgrace. The uprising was enthusiastically named *La Gloriosa*, which can in fact be viewed as a glorious effort that restored national pride after the dreadful blow of the Rio de Janeiro Protocol.

As it happened, Ecuador's financial fallout started a series of events that ended with the greatest tragedy in the nation's history. The country could never recover from the demise of the cacao trade, and the turbulent decade of the world financial crisis could not be controlled. From 1931 to 1940, no less than fifteen heads of state and twenty ministers of finance tried to lead Ecuador. The financial ruin assured Ecuador was unable to maintain political stability, which in turn severely affected all diplomatic efforts. Further, it became impossible to fund a proper military that could have been prepared for war.

As the United States war effort pulled that economy out of the Great Depression, the strategic decisions to consolidate U.S. presence in Latin America bonded the economies of Ecuador and the United States. As in World War I, the United States took over the decreasing exports to Europe. Further fueled by escalating wartime spending, the United States acquired a virtual monopsony of Ecuadorian goods. Panama hats, balsa wood, and rubber exports significantly increased. Further, as the U.S. diminished trade with Japan in protest of Japan's expansionist actions, culminating with a complete embargo on July 1941, Ecuador took over and became a leading supplier of rice to the United States (see table 24). By 1944, rice was Ecuador's leading export, representing 27.5% of all exportations. In all, Ecuador's exports to the United States increased from $7.5 million in 1939 to $28.6 million in 1944; Ecuador's imports increased from $11.2 million in 1939 to $24 million in 1945.[122]

Table 24: Selected Ecuadorian exports as a percent of total value, 1939-1945[123]

Year	Cacao	Coffee	Rice	P. Hats	Crude Oil	Balsa	Rubber
1939	22.1	9.1	4.0	3.0	14.4	1.7	2.6
1940	17.5	9.8	8.7	3.9	14.8	1.9	2.3
1941	17.2	11.9	11.6	8.1	6.7	4.2	3.5
1942	13.5	5.8	17.2	7.4	8.3	8.6	11.9
1943	13.2	11.0	24.1	6.4	6.1	11.0	5.9
1944	9.0	9.3	27.5	14.8	6.2	6.8	8.2
1945	14.2	11.3	16.0	18.4	7.4	4.9	6.2

Ironically, Ecuador's financial situation improved in the immediate aftermath of the war with Peru. The U.S. economic machine that originated with the war effort tagged Ecuador along with increased trade between both nations. Long sought-after foreign capital came in the 1940s when an Export-Import Bank loan to Ecuador was granted for the building of the Pan-American Highway. The North Americans also constructed military bases in Salinas and Galapagos. Customs revenue as a percentage of national income steadily increased throughout World War II with the exception of 1941 where decreased oil exports signified a decrease in customs revenue, perhaps due to the issues regarding Royal Dutch Shell in the oil-rich regions of the Ecuadorian Amazon during the conflict with Peru (see table 25). With customs revenue, government income also increased during the war years (see table 26).

[122] Pineo, *Useful Strangers*, 1439.

[123] Rodriguez, *Government Finances and the Search for Public Policy*, 180-181.

Table 25: Customs revenue as a percentage of national government income, 1939-1945[124]

Year	Absolute Amount in sucres	% of national income
1939	35,571,000	30
1940	43,518,000	40
1941	38,709,000	36
1942	53,398,000	41
1943	67,501,000	40
1944	95,237,000	45
1945	90,203,000	36

Table 26: National government income, 1939-1946[125]

Year	Absolute Amount in sucres	Year	Absolute Amount in sucres
1939	117,187,000	1943	168,284,000
1940	108,533,000	1944	211,958,000
1941	109,001,000	1945	252,717,000
1942	128,985,000	1946	298,813,000

However, as World War II came to an end in 1945, so did the benefits of commerce with the United States. Moreover, the Velasco government's complete disregard for fiscal discipline and even a blatant case of misappropriation of funds, in which Velasco himself, with no proper authorization, made use of $6.5 million from the Central Bank with the pretext of directing them to pressing public works projects, resulted in a bloated and corrupt bureaucracy.[126] The misallocation of funds that was well underway, usually with the ploy of funding public works projects, was reminiscent of the pre-Kemmerer liberal era. The irresponsible patterns of Ecuadorian politics returned with force as the economy started to recover during World War II.

And so, as Japan surrendered after receiving the wrath of two atomic bombs, Ecuador once again suffered the effects of a weak economy. To keep up with fiscal indiscipline the Velasco government simply printed more bills, causing devastating inflation yet again for Ecuador. After a quarrel between the president and his minister of Defense, Colonel Carlos

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[124] Rodriguez, *Government Finances and the Search for Public Policy*, 189.

[125] Rodriguez, *Government Finances and the Search for Public Policy*, 220.

[126] Academia Nacional De Historia Militar, comp., *Historia militar del Ecuador*, 489.

Mancheno Cajas, rumors began circulating that the minister would be deposed. The colonel, beating the president to the punch, took up arms against Velasco and forced him to resign on August 24, 1947, a day properly known in Ecuadorian history as *El Manchenazo*.

With efforts aimed at keeping constitutional rule, colonel Mancheno supported the succession of Vice-president Mariano Suarez Veintimilla after himself acting as supreme chief for ten days. On September 2, 1947, Suarez Veintimilla would assume the role of acting president of Ecuador and immediately organized elections in parliament for a new head of state. On September 17, with the principal objective of organizing general elections, Carlos Julio Arosemena Tola assumed the presidency until August 31, 1948. The end of Velasco Ibarra's second presidency and subsequent re-organization of politics in Ecuador marked the end of the Age of Crises in the country.

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