

Campagna per
la riforma della
Banca Mondiale



The Daule Peripa Project

Italy's responsibilities in Ecuador's
illegitimate debt



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Foreword

This report is based on the information published in the Executive Summary of the report drawn by Ecuador's Public Debt Audit Commission (Comisión para la Auditoría Integral del Crédito Público, CAIC) as well as on other information gathered during a mission in Ecuador organised in July 2008 by the Campagna per la Riforma della Banca Mondiale (Campaign for the Reform of the World Bank, CRBM) and the Legal Advice Centre for Afro descendants and indigenous people (CLAI) in order to evaluate the social and environmental impacts of the Daule Peripa dam and the associated Italian-funded Marcel Laniado De Wind hydropower plant.

Almost 30 years after the building of these two big structures, almost fifty thousand people, most of whom have become isolated inside the artificial basin created by the Daule Peripa dam, still suffer the consequences. Unfortunately, they still have not received any form of compensation. The CAIC analysed the debt derived from the international loans granted to finance this project and found that it had cost the Ecuadorian government much more than expected; what is more, objectives have not been fulfilled and the actual power generation capacity is much lower than its estimated value.

After 14 months' work, the CAIC found evidence of illegitimacy and illegality in the credit granted for the building of this colossal infrastructure, including the bilateral debt owed to the Italian government for the construction of the Marcel Laniado De Wind hydroelectric plant.

1. Ecuador's Public Debt Audit Commission

Executive decree n.472 of 9th July 2007 issued by President Rafael Correa Delgado set up the Public Debt Audit Commission (CAIC).

Its main purpose was to "Audit the agreements, contracts and other means and methods of acquiring public debt in Ecuador, governments' providers, multilateral financial system institutions or the banking system and the foreign and domestic private sector, from 1976 to 2006"¹. The decree defined auditing as a ministerial official action aimed at "examining and evaluating public debt contracting and/or renegotiation processes, the intended use of the loans and the implementation of programs and projects financed by foreign and domestic loans in order to determine their legitimacy, legality, transparency, quality, efficacy and efficiency, considering the legal and financial aspects, and the economic, social, regional, and environmental impacts, as well as the impact on all genders, nations, and peoples"

The Commission was organised in six sub-commissions and was chaired by a representative of Ecuador's Ministry of Finance. It also included representatives of Ecuadorian social organisations, international movements promoting debt relief in the Global South, and consultants from state control and anti-corruption agencies.

On 20 November 2008, the Ecuadorian government published the summary of the Commission's Final Report. One of the findings of this report, as the Commission pointed out, was that between 1976 and 2006 Ecuador negotiated 286 credit agreements with multilateral bodies, totalling USD 12,500mn, which amounted to 42% of Ecuador's foreign loans contracted in that period. In the time frame covered by the audit, the Ecuadorian government signed

1 <http://www.auditoriadeuda.org.ec>; official English translation available on : www.mmree.gov.ec/mre/documentos/ministerio/deuda_eng.pdf

some important financial agreements with astounding swiftness. On 10 February 1995, for example, while the administration of President Sixto Duran Ballen signed a loan agreement with the Inter-American Development Bank (IDB) to buy US Treasury bills as security for issuing "Brady bonds", the Ecuadorian



government also took on four more loans from the World Bank, which involved a structural adjustment programme, a debt reduction programme, technical assistance for the reform of state owned enterprises, and technical assistance for modernising the public sector.

The valuable audit carried out by the CAIC highlighted the total lack of monitoring and popular participation in decision-making. This was especially the case with the Ministry of the Economy and Finance, who had direct contact with Washington officers but not with local communities, campesinos, and indig-

enous peoples. These stakeholders were those who, for decades to come, were to suffer the economic, environmental, and social impacts caused by the building of major infrastructure and by the important political and economic measures the government pledged to

implement with the World Bank and the international donor community. Hundreds of loans were granted at largely unfavourable conditions for Ecuador and its population; most of the time, they were tied to the awarding of multi-million contracts to foreign companies for projects that did not always yield the expected benefits. In 1981 alone, multilateral financial

institutions granted loans to Ecuador for a total of USD 574mn for the “construction of development projects”.

The historical analysis of Ecuador’s debt confirms in every particular what may be called the “consolidated practice” of international financial institutions who, since the late 1970’s, have been using the leverage of major infrastructure financing to assist the penetration of big US and UE companies in Southern economies. By so doing, on

the one hand, they acted as a forerunner for other donors, like export credit agencies, granting loans and security on condition that companies from their country take part in the building of a project; on the other hand, by means of structural adjustment programmes, they started imposing a neo-liberal economic model on the economies of poor countries.

The Brady Plan

The Brady Plan was designed by former US Treasury Secretary Nicholas Brady in order to “help” South American countries out of the debt crisis that was hitting their economies one by one. The plan, created in 1989 with the full support of the International Monetary Fund (IMF), aimed at establishing a financial tool which would allow South American countries to sell part of the defaulted debt originating from the issuance of government securities and credit granted by merchant banks. Development banks thus provided new loans to Ecuador and other countries for the purchase of US Treasury “zero-coupon” bonds, which would guarantee the issuance of new Treasury bonds by the Ecuadorian government. The so-called Brady bonds were meant to create new liquidity and a distribution of risk on the financial market.

Ecuador started implementing the Brady Plan in 1993. The outcome of this operation greatly benefited private commercial banks, whose credit to Ecuador was almost entirely recovered, and the US government, whose own public debt was paid off. The impact on Ecuador’s economy, on the contrary, was devastating. Ecuador’s foreign debt continued to rise, while the financial situation worsened. Poverty became widespread and the government did not have enough liquid assets to meet the needs of the population. Alejandro Olmos, an Argentinean lawyer and CAIC member, declared that the review of the files of the Central Bank of Ecuador showed that the country “was not properly recording its foreign debt, had no control [...] and in many cases the same obligation had been paid 2 or 3 times”¹.

Financial agreements were often drafted by the creditors themselves and included extremely disadvantageous terms for Ecuador like, for example, giving up national sovereignty and establishing the primacy of the agreements above the Ecuadorian law and Constitution². These conditions were accepted by Ecuador for its Brady Plan, for the Adam Plan that followed in 1999, where Brady bonds were swapped into Global bonds, and for the exchange of Brady bonds and Eurobonds to Global bonds in 2000.

With the advent of the debt crisis, international financial institutions bought the debt from international private banks, a debt that increased from USD 1,090mn in 1983 to USD 2,423mn in 1990 and USD 4,100mn in 2000. By that time, the financial crisis was a reality. Millions of Ecuadorians suffered the consequences: the country’s economy crumbled; almost one third of the population emigrated towards Europe or the United States; also, in 2000, the country’s economy was dollarised. According to the CAIC, between 1970 and 2007, Ecuador’s foreign debt rose from USD 240mn to USD 17,400mn.

1 Interview with Eduardo Tamayo G., available on: <http://la5tapatonet.blogspot.com/2008/11/ecuador-las-deudas-se-pagan-las-estafas.html>

2 Personal interview with Alejandro Olmos, Quito, July 2008.

2. Floods of credit to build what?

Since the 1950's, promoting the building of major infrastructure in the Global South has been the driving force behind international recovery in the economy and production in the aftermath of the two World Wars.

The World Bank and regional development banks were the main vehicle for the "large infrastructures doctrine"; they disseminated research and consultancy findings supporting the building of major civil engineering projects (and above all mega-dams) as a major engine of economic growth while, on the other hand, they promoted soft loans tied to the realisation of these projects. During the first 25 years of operation, two-thirds of the Bank's total lending fell under this category. As soon as it appeared that, after the launch of the Marshall Plan, there was little left to do in Europe, the lending operations of the World Bank (which was then called International Bank for Reconstruction and Development) rapidly started heading South, starting from Latin America. During the 1970's, 1980's, and the early 1990's, infrastructure loans wavered between 50% and 60% of available funds (hitting a record USD 10bn in 1993). Rhetoric on the development of poor countries, big dams, motorways, and other major civil works and soft lending

went hand in hand with the promotion of an infrastructure culture endorsed by international consultants

Ecuador too, just like other South American countries, took advantage of this wave of easy lending unleashed by international financial institutions

who were commissioned by the World Bank to produce studies that could justify the money that was being poured by international donors into the building of major projects.

Ecuador too, just like other South American countries, took advantage of this wave of easy lending unleashed by international financial institutions and the donor community to start the building of some mega-infrastructure projects. At the top of the agenda was the Jaime Roldos Aguilera multipur-



Picture: large extension of eichornia nearby the Los Angeles community, Manga del Cura territory

pose project, ironically named after Ecuador's first democratically elected president after over a decade of dictatorship. He died in a mysterious plane crash in May 1981, after less than two years in office. His death opened the way for an aggressive entry of US economic policies and international financial institutions into the country. A few months after Aguilera's death, the Inter-American Development Bank granted the first loan to start the building of the Daule Peripa dam. That was the first step towards Ecuador's dependency on foreign financing, which would eventually lead the country to run up a foreign debt of tens of billions of US dollars for major public works that were not always needed, not always properly built, and not always complying with international social and environmental standards. These works benefited contracting companies, not the Ecuadorian people, who bore the economic and social brunt of an onerous but not always legitimate external debt.

3. The Daule Peripa project

The Daule Peripa dam is the milestone around which, over the years, various components of the Jaime Roldos Aguilera multipurpose project – the largest and most complex infrastructure project built in Ecuador in the last forty years – were developed.

The project was launched in 1982 with the start of the building of the Daule Peripa dam. Over the years, it was modified and extended to become a highly structured, interdependent, and continuously evolving network of infrastructures for water collection, canalisation, and hydroelectric power generation. The report “Siembrando Desiertos” written in 2006 by *Alianza de Pueblos del Sur* *Accreedores de Deuda Ecologica*, *Accion Ecologica* and *Instituto de Estudios Ecologistas del Tercer Mundo* started reconstructing the intricate story of this project, including all the

public and private stakeholders who, over the last 30 years, have participated in various capacities to the planning, building, and financing of the project, dealing with a rapid succession of short-lived governments that ruled Ecuador after President Roldo Aguilera’s death. Each government contributed to a different extent to find the external financing needed in order to keep building this mega project and guarantee juicy contracts to the contracting companies involved. All this occurred among corruption scandals, tied aid, and substantial cost escalations. The story of Ecuador, of its political elite, and of the struggles between internal and external power groups are intertwined with the events of this project, which remained for a few decades at the top of Ecuador’s political agenda.

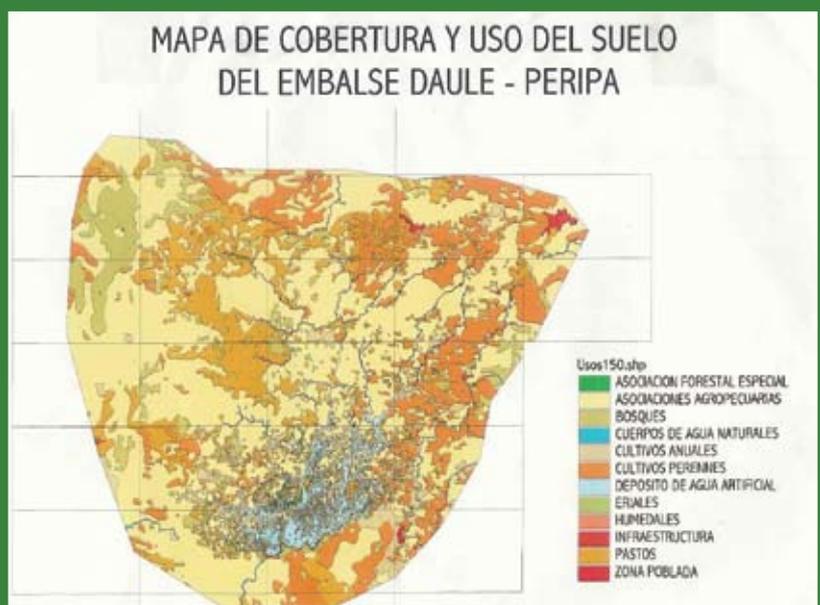
3.1 Ecuador’s “white gold”

Ecuador was one of the first Latin American countries who discovered its huge water potential. In 1965, the government set up a Study Commission for the

The Guayas basin¹

The Guayas river basin is the biggest river basin of the South Pacific. It covers about 12% of Ecuador’s territory stretching over about 34,000 square kilometres. It is inhabited by over 5 million people, accounting for 35% of the country’s population. The basin is located in the Western part of Ecuador, between the coast and the Andes Highlands, and it is the most fertile and important area for Ecuador’s economy. The Guayas basin contributes to about 40% of GDP. With about 3mn hectares of farmland, the Guayas basin accounts for 37.5 % of Ecuador’s 8-million-hectare estimated total farmland.

The tributary basin of the Daule river is the largest sub-basin of all, occupying the north-



1 Subcomision para la Auditoria Integral de la Deuda Publica en Cedege (CAIC), “Analisis de Impactos Socio-Ambientales derivados de las obras de infraestructura en el Embalse Daule Peripa”, July 2008, Guayaquil, Ecuador.

Development of the River Guayas Basin (CEDEGE) with the aim of researching and designing actions to promote the economic and social development of the Guayas basin, which was one of the major water reservoirs in the whole continent.

The idea underlying the creation of CEDEGE was to optimise the use of water resources for farming and provide protection from floods and water supply for the city of Guayaquil and other coastal towns in the region, where drinking water was scarce and the soil was dry and sandy, which hindered cultivation. The Ecuadorian government hired an important US consultancy firm, TAMS – Tippet, Abett, MacCarty, and Stratton, who at that time worked with the World Bank – to carry out a pre-feasibility study. This firm also drew most of the projects that were financed by the World Bank in those years. This study, published in 1978, was realised with the participation of various other international consultancy firms. It dealt with the building of the Daule Peripa dam, an 85-metre high and 250-metre long construction made of natural materials like stone and sandstone impounding a 6 billion m³ reservoir. The reservoir was designed to be 18 kilometres long, and to inundate 30,000 hec-

ern part of the Guayas basin. Before the dam was built, it stretched over 420,000 hectares, that is 35% of the Daule river basin and about 12% of the Guayas basin.

The artificial basin created by the dam on the Daule river, south of the point of confluence with tributary river Peripa, inundated a surface of almost 30,000 hectares of land belonging to four provinces: Los Ríos, Manabí, Santo Domingo de los Tsachilas, and Guayas. The largest territory inside the basin belongs to Manabí, with five cantons (Pichincha, Chone, Bolívar, Flavio Alfaro, and El Carmen), followed by the Guayas province (a hamlet of Las Guayas and the canton of El Empalme), Los Ríos with the canton of Buena Fe, and the province of Santo Domingo de los Tsachilas. There is also an undelimited area known as La Manga del Cura, which does not fall under the administration of any of the four provinces and where several hundred people live.

tares of land 88 metres above sea level. According to the study, the building of this dam and the creation of this huge reservoir would have improved fishing and river traffic conditions on the river Daule as well as promoting tourism. The pre-feasibility study reckoned that the dam would have opened up a variety of opportunities for infrastructure development, such as the building of canals and water transfer to the Manabí province. These projects were planned to meet regular water shortages and irrigate about 100,000 hectares of farmland. Half of this land was situated in the lower part of the Daule river, an area regularly exposed to floods which the dam would have helped harness; the other half, on the contrary, was in the Santa Elena peninsula. As illustrated below, these objectives were only partially achieved whereas project costs spiralled.

The involvement of a public institution in the project attracted tens of foreign companies who were looking to build additional works

In 1978, Ecuador did not have the financial resources needed to fund the design and the building of each single project envisaged by the pre-feasibility study, and primarily the crucial Daule Peripa dam. The project was stalled for a few years. Then, a report by the Inter-American Development Bank brought it back to the fore, at a time marked by the sudden passing of President Roldos Aguilera. In 1982, Ecuador was granted the first loan of USD 189.9mn by the IDB to start the construction of the dam.

The involvement of a public institution in the project attracted tens of foreign companies who were looking to build additional works that could possibly be added to the project; several foreign governments were willing to fund individual project components too, in order to then award hefty contracts to their own flagship companies and consultants. As a result, over the years, new project components were designed and included in the initial pre-feasibility study, producing a complex series of infrastructure projects. Even now, twenty-five years on,



Picture: Marcel Laniado de Wind hydropower plant. View from the road on the Daule Peripa dam.

According to the CAIC report...

.... seven multilateral loans were contracted to finance this project, totalling USD 466.4mn.

Additional bilateral debt was contracted with different foreign governments, including Italy, to finance single project components: the Daule Peripa dam, the Marcel Laniado de Wind hydropower plant, and the water transfer from the Daule river to the Santa Elena peninsula. The report asserts that these works “demanded the greatest efforts deployed by the country in order to satisfy regional necessities, based on the large amount of resources almost completely proceeding from the foreign debt.”

In order to build these projects, between 1982 and 2006 Ecuador underwrote loans totalling USD 1,203,302,432: over USD 248mn of that figure was channelled into the Daule Peripa/Marcel Laniado De Wind hydropower plant. It was an extraordinary amount of money for a project that has not yielded the expected benefits and a power plant that currently generates only one third of the expected power output.

new areas of development are being added. Tens of consultancy firms, companies, international financial institutions, and donor governments from all over the world funded this project, on the basis of agreements made with a string of different administrations that ruled Ecuador in a time of high political and economic instability.

From July 2007 to September 2008, Ecuador’s Debt Audit Commission reviewed the bilateral and multilateral loans granted for the building of different project components of the Jaime Roldos Aguilera project, assessing their impact on the country’s economy and on the life of the local population.

3.2 The energy crisis and the development of hydropower in Ecuador

The 1970’s crisis had a severe impact on Ecuador’s economy, which at the time was heavily dependent on exports (especially oil and few other agricultural products). Rumours of an energy crisis started spreading as early as the early 1980’s. Dwindling oil reserves and, on the other hand, operating problems of the Paute hydroelectric plant, Ecuador’s largest hydropower plant, fuelled the debate on the need to exploit the country’s water potential to generate energy. In July 1988, the World Bank together with the United Nations Development Programme (UNDP)

carried out an analysis of Ecuador's short- and medium-term energy issues. This study was paid for by those two institutions and the Italian government; it was realised in collaboration with the local Institute for Energy and it was used to justify the building of the Daule Peripa hydroelectric plant.

In actual fact, the research highlighted several problems in the running and maintenance of existing power plants, and first of all the serious technical difficulties concerning the Paute power station, also built by Italian companies. The study went so far as to cast doubts on the cost-effectiveness of the proposed measures. The questions raised by the study addressed some important issues, which should have been given due consideration in the context analysis of the site's surrounding area. This would have led to a better assessment of the project's impacts in terms of economic and social growth and poverty alleviation. The study found several problems in electricity generation and distribution; in particular, it noted the difficult economic and financial situation of Ecuador's state electricity company INECEL, caused by major investments in new hydroelectric projects (including the various phases of the Paute plant), rising foreign debt, increased inflation, and the devaluation of the local currency, the sucre. Within this framework, it would have been difficult for Ecuador even to recover the costs of building a further hydroelectric plant, funded with external loans largely paid in hard currency. In fact, this project ended up

Table

Electricity Subsector: *power capacity and power generation of the Paute and Daule Peripa projects*. INECEL, Master Electrification Plan

Project	Power capacity (MW)		Energy (GWh)	
	Installed	Firm	Primary (dry year)	Mean (mean year)
Paute AB	500	377	2495	2631
Paute ABC	1000	769	2270	5138
Daule-Peripa	130	74	432	505

Source: World Bank
<http://www-wds.worldbank.org>

worsening Ecuador's economic situation and increasing its foreign debt without guaranteeing access to energy for the country's poorest population living in rural areas, beyond the reach of electricity supply networks.



Picture: sign nearby the workers citadel set up for the construction of the Marcel Laniado de Wind hydropower plant

3.3 Power generation or drinking water distribution?

Between 1984 and 1988, when the building of the Daule Peripa dam was almost finished, Hidroservice, a Brazilian consultancy firm, drew up a project to build a hydroelectric power generation unit to be added to the dam. According to this project, a

hydroelectric plant would have generated energy as an "ancillary service", using the water discharged by the power station when the reservoir level rose above a given limit. According to the project, the estimated cost of USD 53mn could have been used to build a 130 MW hydroelectric plant adjacent the Daule Peripa dam, powered by two 65 MW Francis type turbines. The turbines would have become operational

by converting drainage tunnel number two of the dam into a turbine inflow channel with a proper armature and protections. The project also envisaged the building of ancillary facilities, an access route, the creation of laboratories and offices, and a citadel to

host about 1,000 workers.

As noted in several hydroelectric projects and later also in the report produced in 2000 by the World Commission on Dams, the generation of hydroelectric power could be at odds with the general purpose of the project, which was to collect and distribute drinkable water. Once the hydroelectric plant would be completed, it would appear unreasonable

to expect that power generation would remain an ancillary service provided by the multipurpose project. If nothing else, in order to be economically sustainable and guarantee the recovery of the high construction costs involved, the plant

would have to operate at full capacity and sell the power it generated at market prices.



Picture: the Ansaldo generator installed in the Marcel Laniado de Wind hydropower plant.
Source: CAIC's technical group.

According to the CAIC report....

... Bilateral financing from the Italian government aided the Italian companies who had signed the construction contract, that is Ansaldo and its associated companies.

The report reads "Caused by the financing offer which at the date of tender had not yet been specified, this was restricted to Italian firms in association with national local firms". In fact, the co financing by the Italian government was approved only four years later. "For the financing of 20%, the tender process was limited to Italian companies limiting therefore the competition".

Conclusions of the World Commission on Dams (2000)

In the last century, about 80 million people were displaced due to the construction of over 45,000 large dams; many of them were not resettled or offered alternative land or cash compensation as promised by the authorities in charge of the projects. At least 10 million people were displaced in projects supported by the World Bank who, up to the end of the last century, had lent USD 75bn for the construction of 538 large dams in 92 countries. This accounts for one tenth of all the loans given since its establishment.

Often, large dams fail to produce the expected benefits; they take a much longer time to build than anticipated (construction deadlines were not met in 50% of the cases); finally, on average, they cost 56% more than planned, which often provides significant leeway for corruption. Here, it would suffice to mention the Lesotho scandal, where the world's largest multinational corporations specialised in dam projects were found guilty of corruption in the framework of a colossal project financed by several international donors, and the Yacyretà dam, on the border between Argentina and Paraguay, financed by the World Bank with the involvement of Italian company Impregilo, labelled by former Argentine President Carlos Menem "a monument to corruption" due to the astronomical increase in the costs involved.

If one considers hydroelectric plants, it appears that one fifth of all projects achieved less than 75% of their power generation objectives; as for irrigation dams, 50% of them did not operate as planned in terms of irrigated area and collected water quantity, while 70% of water supply dams did not meet the expected goals. Finally, in this particular instance, dams built for flood control in some cases seem to have aided flooding rather than averting it. Still, in the United States, about USD 38bn were channelled into these projects between 1960 and 1985 in spite of the fact that destructive floods increased by over twofold.

Flooding of vast forests and green areas in tropical regions following the creation of dam reservoirs has often led to high emissions of greenhouse gases like methane which, due to its physicochemical characteristics, stays in the atmosphere for longer periods. Consequently, quantities being equal, methane contributes to the greenhouse effect more than other gases. It has been estimated that these emissions could account for up to 28% of potential global warming and the ensuing climate changes.

3.4 A major coup for Italian companies

Just like it happened with other project components, when it came to the Daule Peripa hydropower plant, Ecuador did not have the funds to start building the project proposed by Hidroservice. A few years passed before the government of Ecuador issued an invitation to tender to build the plant. The tender was called on 8th August 1991 and it was only open to Italian companies. Only two consortia participated: one was formed by Ansaldo Gie SpA, Impresit-Girola-Lodigiani "Impregilo" SpA, Icis Impresa Costruzioni Idrauliche Stradali SpA, and Equidor SA; the other consortium, on the contrary, included Recchi SA Costruzioni generali, Compania General de Construcciones Cia Ltda, Constructora Modular Cia Ltda, and Agi Electrica Cia Ltda. The tender was closed by CEDEGE without any bids on 30th October 1991 as the proposals received were deemed inadequate. On 6th December 1991, CEDEGE called a second tender, which was participated by the same consortia. This time, however, the consortium headed by Ansaldo won the contract

to build the hydropower plant for a total revised discounted value of 142,726,799,617

Why did CEDEGE decide to call such an attractive tender inviting only Italian companies?

Italian lire plus 56,665,016,502.77 sucres, which at the time amounted to approximately USD 160mn (about three times the costs estimated in the original Hidroservice study).

Why did CEDEGE decide to call such an attractive tender inviting only Italian companies?

Some interviews gathered during our field mission confirmed that when the contract was signed the Italian government still had not granted Ecuador any concessional loan to build the plant. Therefore, the Italian government had not given any funding that could in any way bind the Ecuadorian administration to use Italian companies to build the project. Upon request of the Ecuadorian government, this project was included in the 1990-1992 Italo-Ecuadorian cooperation programme and it appeared in a long list of other projects that were never financed. The building of the power plant was stalled due to lack of funds until 1995, when the Italian Foreign Ministry granted a concessional loan of 98,998,004,000 Italian lire, which the Italian government used to finance the realisation of the Daule Peripa hydropower plant,

later known as the Marcel Laniado De Wind hydropower plant.

The amount granted was lower than the one agreed in the contract between CEDEGE and the consortium of Italian companies; still, it was enough for the consortium not to lose the contract. If the Italian government had not financed the project, CEDEGE would have had to issue a new invitation to tender but this time without any restraint of competition, which would have meant that other foreign companies would have been allowed to submit their bids. But things went quite differently. The Italian government negotiated a reduced credit amount and the consortium did not lose the contract, while another external lender – the Corporacion Andina de Fomento (CAF) – got involved in the project, covering the balance of the dam costs.

4. Environmental and social impacts

The Daule Peripa dam produced huge environmental and social impacts both upstream and downstream. The reservoir flooded one of the country's most fertile areas, which used to be almost entirely devoted to agricultural production for local markets.

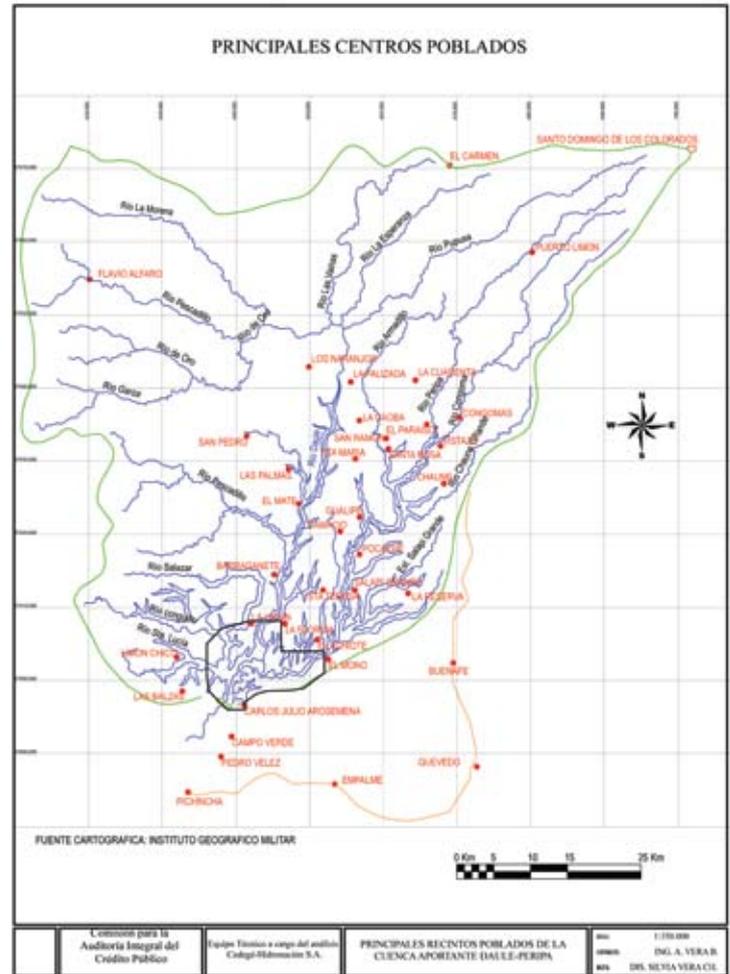
The interviews made during the mission showed that this territory was divided into hundreds of small plots and little more than family-run farms (fincas). It was a very rugged area, with an endless series of hilly belts crossed in the middle by rivers Daule and Peripa. The construction of the dam blocked almost entirely the flow of both rivers, with major impacts downstream that have never been assessed. Upstream, on the other hand, the inundated area extending up to about 100 km north of the dam. At the sides of the main dam, there are some storage dams which already show worrying signs of decay. They were built to prevent the reservoir from expanding to lateral areas in a territory that is difficult to cross and that could stretch over 50 to 100 kilometres. The CAIC report claims that the reservoir forced 14,965 farmers from 8 villages of the flooded area out of their land while 63 communities were isolated. The Ecuadorian civil society organisations working in that territory assert that about 50,000 people have been directly or indirectly affected by the reservoir. After interviewing some of the people living in the

isolated communities, it appeared that, over the years, only very few farmers managed to get some form of compensation for the damage they suffered. Most of them did not have ti-

tle deeds to their lands or information on how to get compensation.



Picture: in some parts of the basin, the eichornia extension covers the entire water surface



After losing their home, their land, and their cattle, many families were forced to migrate to other parts of the country, mostly towards the coastal town of Guayaquil.

During the interviews among different communities, several witnesses pointed out that water levels seemed to have increased by at least 10 metres above the limit, reaching hillsides that were not to be flooded according to CEDEGE forecasts. Thus, many people lost much more land than expected and suffered an additional damage that has never been compensated. In its report, the CAIC states that erosion affects about 85% of the reservoir which, in the last few years, has caused a further loss of land. According to local communities, the Daule Peripa basin is now 70 to 80 metres deep, with murky, lifeless waters.

The local communities who have been isolated inside the dozens of water fringes of the reservoir still live in extreme poverty. Their dwellings have not been



Picture: the long roots of the *eichornia* intertwines under the water surface, creating a barrier for the sunlight and making extremely difficult to navigate the reservoir

rebuilt; they do not have access to electricity and drinking water; they live in self-built houses without health care or roads and they are forced to cultivate very low-yield land – about one fifth of the average productivity – which was the only land left after the creation of the reservoir. The CAIC Report also pointed out that the shortage of basic services among the communities living inside the basin is one of the highest in the country. Between 70% and 90% of residents do not have access to drinking water. The Report reads “the cantons and parishes affected by the project are among those with the worst living conditions”.

The Report goes on to observe that the creation of the reservoir was a critical factor in the deterioration of the ecosystems of rivers Daule and Peripa. The lack of maintenance and the failure to clean the reservoir bottom before inundation soon led to water eutrophication. The CAIC Report maintains that about one third of the 27,000 hectares of the reservoir is covered by an invasive aquatic weed, the *Eichornia crassipes* (water hyacinth), which the local population calls “lechuguin”. Its rapid growth and proliferation pose serious environmental problems. Its long roots under the water surface can reach up to one metre in length; they rot fast producing unhealthy emissions and water pollution. The formation of large carpets of *Eichornia* on the basin surface makes it impossible for fish and other aquatic plants to survive. Moreover, intertwined roots under the water surface make it extremely difficult to navigate the reservoir waterways separating different communities. Crossing these waterways is now possible only in some specific spots thanks to private initiative; in fact, some individuals built some homemade barriers which in some points stop the proliferation of the infesting weed. Local communities have to pay a toll fixed by private individuals who manage

the crossings but most people cannot afford it. What is more, these plants also carry infectious diseases. Flies and mosquitoes lay their eggs inside aquatic plants; over the years, this increases the incidence of infectious diseases such as malaria and dengue, including the haemorrhagic dengue variant, which affect local communities with relatively high morbidity. Interviews showed a particularly high mortality rate among children and the elderly, mainly caused by hepatitis resulting from the consumption of non-drinkable water and by mosquito-borne infectious diseases. The lack of locally available medical care and the tortuous route to reach Guayaquil hospital – the only centre equipped to deal with malaria and dengue emergencies – often mean death or permanent disability for the residents of the most isolated communities.

Like other water collection projects in Ecuador, the Daule Peripa reservoir too experiences significant sedimentation caused by the constant accumulation of sandy soils washed by rivers Daule and Peripa into the reservoir bottom. Over the years, this has caused the total reservoir water capacity to decrease. According to local communities, who have developed their own method of measuring sedimentation, in some points the level of sediment on the reservoir bottom increases by over 10 metres every year. The engineers of the CAIC technical group believe that these sediments could represent a cost for the hydroelectric plant too as they would speed up the wear of the turbines¹.



Picture: the flower of the *eichornia*, also known as water hyacinth

1 Subcomision para la Auditoria Integral de la Deuda Publica en Cedege (CAIC), “Análisis de Impactos Socio-Ambientales derivados de las obras de infraestructura en el Embalse Daule Peripa”, July 2008, Guayaquil, Ecuador.

5. Is this debt illegitimate?

Italy's decision to finance the Marcel Laniado De Wind hydroelectric plant was made almost ten years after the construction of the dam, started in 1982, and the creation of the reservoir.

By that time, several negative aspects of the project were already obvious: the failure to apply international environmental and social standards, the poor maintenance of the basin; the environmental and social costs resulting from the lack of a compensation scheme for local populations; the lack of essential facilities for those populations, in particular the ones isolated within the reservoir area; last but not least, the serious environmental impacts produced by the inundation of thousands of hectares of land. In 1995, it was also clear that several loans that had already been contracted by different Ecuadorian administrations for the building of this mega infrastructure project were not achieving the expected results.

In addition, in those years, Ecuador was going through an increasingly serious debt crisis, which was especially due to the numerous loans contracted for the building of the dam and other facilities included in the Jaime Roldos Aguilera project. This led to some serious economic and social problems, which the new loans needed for the construction of the hydroelectric plant could only aggravate. In 1994, Italy was Ecuador's largest bilateral creditor, with a total credit accounting for 22% of Ecuador's debt to the Paris Club. According to some information gathered during our field mission, compensation to

According to the CAIC report....

... in the planning phase, the benefits of the project were perhaps exaggerated.

In the loan contracts, for example, one of the objectives included "irrigating 100,000 hectares; 50,000 along each bank of the Daule River". The report, on the contrary, remarks that "in reality only 17,000 hectares were irrigated" and that "other predicted benefits like boating, recreation and tourism never happened. In fact, the opposite occurred".



Picture: artisanal crossing bridge built by private individuals in the Manga del Cura territory

be claimed by the Italian Export Credit Agency, SACE, as of 31st December 1993 totalled 207bn lire, about 77bn of which derived from previous debt restructuring agreements. In those years, Ecuador was going through the sixth restructuring of its debt to Paris Club donors.

5.1 Violation of the spirit underpinning the guidelines of Italian development cooperation and lack of due diligence on the part of the Italian government

When the Italian government decided to allocate the entire budget available for development cooperation with Ecuador and almost half of the budget devoted to the whole of Latin America to a single project – the Marcel Laniado De Wind hydroelectric plant in Ecuador – it did so after considering the effectiveness of this massive allocation of money in terms of poverty reduction. Unfortunately, these considerations were never shared with the public or with Italian and Ecuadorian civil society organisations, who can therefore only acknowledge the results when assessing the development impacts of the project. The facts show that in those years, the World Bank identified rural communities – those who lost their land due to the Daule Peripa project and who still suffer its impacts – and indigenous people as the poorest among the poor. In total, over 63% of Ecuador's population lived under the poverty line and over half of them languished in conditions of extreme deprivation. The Italian-funded project did not produce any benefit

for these people: most campesinos and indigenous people living in Ecuador still has no access to the national electricity grid and consequently cannot benefit from the power generated by the Marcel Laniado De Wind plant.

The local communities living on the dry islands formed after the creation of the reservoir are now much worse off than before the dam and the associated hydroelectric plant were built. They have been left without basic services or transport and communication routes, and without the land and rivers they used to depend on to lead a dignified life.

The choice to finance the construction of the hydroelectric plant therefore seems to conflict with the underlying principles of Italian cooperation operations, listed in law n. 49 of 26th February 1987 "New discipline of the Italian Cooperation with developing countries". Article 1.2 of law 49/87 establishes that "[development cooperation] aims at satisfying basic needs and, in the first place, safeguarding human life, food self-sufficiency, promoting the development of human resources, safeguarding the environmental heritage, implementing and strengthening endogenous growth as well as economic, social, and cultural growth in developing countries".

Moreover, it seems that the Italian government failed to exercise due diligence by not assessing whether it was actually appropriate to finance this project to the detriment of other smaller, less costly projects in other fields. Projects like, for example, the provision of basic services would have had a direct beneficial impact on poorer communities, who at the time, as illustrated above, accounted for over half of Ecuador's population. The Italian government should have also assessed the added value, if there was any, that the hydroelectric plant would have brought to the multipurpose project, as well as considering the achievement of the broader social and economic growth objectives set out by the Italian Cooperation for Ecuador. The everyday living conditions of the

Picture: village not far from the Daule Peripa dam



affected communities, the environmental degradation occurring in a large part of the flooded area, and a power plant that has never generated all the power it was expected to yield all go to prove the failure of this operation on the part of the Italian Development Cooperation.

5.2 Failure to comply with World Bank guidelines

Between 1990 and 1995, the Italian government presumably carried out its own evaluation of the hydropower plant project. However, it still remains unclear what standards the Italian Development Cooperation used to assess project eligibility in those years. Major engineering projects realised on the Italian territory were required to produce a comprehensive environmental impact assessment (EIA); for international projects, on the contrary, the standards used were those fixed by the World Bank and contained in Directive 4.00 (Operational Directive 4.00, Annexe A) of 1989 as amended in Directive 4.01 of 1999 on environmental impact assessment.

Therefore, the Italian government, as part of its due diligence, should have verified the state of the project with which the hydropower plant should have been directly associated. This could have been done, for example, by reviewing the environmental impact assessment of the entire project and requesting that any violation that might have occurred be corrected before disbursing the funds for the hydropower plant. Point 1 in Annexe A of World Bank Operational Directive 4.01 states that dams and hydropower plants are projects classified under the A category, in which case a comprehensive environmental assessment is

The Italian government should have made sure that the required mitigation and compensation measures be established and adequately implemented

required. This assessment should be carried out during project preparation and be closely linked to the feasibility study.

The Italian government should have made sure that the required mitigation and compensation measures be established and adequately implemented, striving to take remedial action in case the populations directly and indirectly affected by the project were not consulted (article 19 of OD 4.01 and articles 5,8, and 9 of subsequent World Bank OD 4.30), received inadequate and partial compensation, if any at all,



Picture: dead end road nearby Santa Maria

or had to leave their land (articles 5,8, and 9 of subsequent World Bank OD 4.30), or again if the adversely affected communities were not provided with basic social infrastructure.

The Italian government should have carried out an overall environmental and social impact assessment instead of simply considering the hydropower plant project as separate from the rest. Evidently, the Marcel Laniado De Wind hydropower plant could have not be conceived and built if the Daule Peripa dam had not been there. A correct application of the World bank guidelines required a technical and economic assessment and a revision of the EIA concerning the dam and the hydroelectric power unit, also considering the fact that this plant was included in a multipurpose project already underway. To this day, no remedial action has been taken to correct the huge environmental and social impacts generated by this project, which were already apparent when Italy got involved. This shows, with little room for doubt, that when the Italian government financed the hydropower plant it paid little heed to international best practices. Building the plant increased the overall cost of the project considerably, which urged the Ecuadorian government to contract three additional loans: an aid credit from Italy and two aid credits from a regional multilateral bank, the Corporacion Andina de Fomento (CAF).

5.3 Failure to pursue the country's development priorities

The Italian government granted a loan of 98,998,004,000 Italian lire (about 45mn Euros) in a period when the Italian Development Cooperation was going through a major restructuring following investigations by the public prosecutor's office in Rome, which involved in those years some political representatives of the Foreign Ministry's General Directorate for Development Cooperation (DGCS, Italian acronym). The 1994 Budget Law slashed the budget allocated to development cooperation considerably; this led to a revision of the goals and priorities of Italian Cooperation interventions. Latin American middle income countries like Ecuador were

considered as secondary priority whereas, on the contrary, operations were strengthened in poorer countries, namely in Africa.

In this new scenario, the financing of the Marcel Laniado De Wind hydropower plant looked even more unusual. In fact, the financial agreement for the power plant between the Ecuadorian government and Mediocredito was signed in November 1995, almost six months after the approval of the new guidelines decided by the institutional responsible body (the Interministerial Economic Planning Committee, CIPE).

There was therefore a reasonable margin of time for the authorities concerned

Available information suggests that the aid credit granted to build the Marcel Laniado De Wind plant was the largest ever granted by Italy to Ecuador.

to question Italy's participation to the project in the light of the new guidelines of the General Directorate for Development Cooperation.

Nevertheless, despite its not being a priority, the Marcel Laniado De Wind hydroelectric project was eventually approved, absorbing almost half of the development aid budget for the whole of South America, which the 1995 Annual report on the implementation of development cooperation policies estimated for that year in about 178bn Italian lire (of which 151bn lire for concessional loans). This anomaly is even more evident if one considers that Ecuador has never been a priority for the Italian government, not even before the restructuring of the Cooperation agency and the drastic budget cuts. Available infor-

According to the CAIC report...

... The Marcel Laniado De Wind hydropower plant was oversized: it has never worked at more than one third of its installed capacity.

The Report says that "... the average power generated in the last 8 years is 75.8 MW which clearly shows the over-dimensioning of the three turbines, which function at 30% of their capacity. This shows that reserve value was non existent or critical flow sufficient to install three units. The decision to build a third turbine could have been justified during the emergency state that the country was going through but not in the long term."

mation suggests that the aid credit granted to build the Marcel Laniado De Wind plant was the largest ever granted by Italy to Ecuador. The 1995 report also noted that during the previous seven years, the Italian government had granted Ecuador a total of 200bn lire, composed of 84bn in aid loans and 116bn in grants.

5.4 Failure to achieve the objectives set

One of the reasons that probably encouraged the Italian government to get involved in this project can be read between the lines of the construction contract that had been signed a few years back between CEDEGE and the consortium of Italian companies led by Ansaldo. The first works contract signed for the building of the project was registered before the Notary Public of Guayaquil Mr Hugo Amir Guerrero Galardo. It stated that: "the execution of this contract shall be financed with funds coming from a cooperation agreement with the government of the Italian Republic with regards to the financing component expressed in foreign currency and with funds coming from the National Budget with regards to the financing component in national currency". Therefore, the contract for the construction of the power plant signed by Ansaldo was to be considered as effective and valid only after the approval of a concessional loan by the Italian government. It was basically a private contract which in fact bound a third party -- the Italian government -- not only to financing the project but also to doing so by means of a soft loan drawn from the official development assistance, a part of the public budget dedicated to interventions for poverty reduction. The financial agreement signed between Mediocredito and the government of Ecuador "for the realisation of the Daule Peripa 130 MW hydropower plant" throws further light on the subject. Articles 5 and 6 contain clear and detailed provisions on how the loan should be used. It appears that this credit was to be used only to pay the invoices issued by the Italian constructor. It was thus inferred that the aid loan would have been transferred directly from Mediocredito's coffers to the project contractor, without entering Ecuador, not even virtually. It was clearly a case of tied aid, as it was granted on condition that an Italian company participated to the project being financed.

Therefore, the aid loan granted by the Italian government for the Marcel Laniado De Wind plant was used to the full benefit of Ansaldo and its implementing

consortium and was not bound to the achievement of the development objectives set.

The enigma of the power of the installed turbines: a fraud against Ecuador?

It also appears that the actual power installed by Ansaldo does not match the agreed capacity. On 30th January 1996, less than two months after the financial agreement was signed between Mediocredito (on behalf of the Italian government) and the Ecuadorian government (22nd November 1995), the consortium led by Ansaldo signed the first complementary agreement with CEDEGE to increase the capacity of each turbine from 65MW to 71MW. On 6th June of the same year, another complementary agreement was signed for the construction of a third 71MW turbine.



Picture: one of the three turbines installed in the Marcel Laniado de Wind hydropower plant. Source: CAIC's technical group

Overall costs thus rose from USD 161.3mn agreed with Ansaldo in 1993 to USD 263.6mn (163.4% of the total cost originally budgeted). Besides this considerable increase in the overall cost of the project, during a number of technical visits to the plant, the CAIC noted that the technical specifications of the three turbines showed a "rated power of 65 MW, a nominal fall of 54.82 metres and a rated discharge of 132.5 m³/second.

These figures contradict the technical specifications contained in complementary agreements N.1 and N.2, which provided for a 71MW installed power; on the contrary, they reflect the capacity agreed in the original contract". The CAIC report goes on to observe that "should this be proven, it would be the evidence of an alteration of data and a fraud for not delivering the specified equipment".

Recommendations and conclusions:

Creditor co-responsibility for illegitimate debt

On 20th November 2008, when the CAIC report was made public, Ecuadorian President Rafael Correa declared: “We will seek to punish the guilty and not to pay the illegitimate debt”.

The first step was to initiate arbitration proceedings against the Brazilian National Development Bank (BNDES) in relation to the loans granted to the Brazilian firm Odebrecht for the construction of a hydropower plant whose contracting process contained serious flaws and whose operation had to be suspended after few years due to some technical problems. .

Moreover, on 12th December 2008, President Correa announced a defaulting on the 2012 Bonds and he also declared a technical moratorium on the payment of USD 30.5mn of interest on the 2015 Bonds.

Besides the proceedings that had already been initiated, this auditing process gives the Italian government the chance to solve one of the many questions still open concerning the projects approved in times when development cooperation was mostly used to support the Italian government’s trade policies and strategies in Ecuador and several other poor countries. In the 1970’s and 1980’s, Italy, as well as other governments, financed several so-called “white elephants” in developing countries. In October 2006, after a long national debate involving the local civil society and some debtor countries, Norway was the first country who decided to close a dark chapter of its history by repairing the damage it had helped to cause in Ecuador. Thus, the Norwegian administration recognised its co-responsibility in a disastrous operation carried out by its development cooperation agency; consequently, Norway unilaterally and unconditionally cancelled all debt claims deriving from a series of loans granted for the purchase of some 1970’s Norwegian ships, which were faulty and in some cases had never set sail.

The operations of the Italian Development Cooperation have been characterised by hundreds of projects

aiming to meet private interests rather than the eradication of poverty. This is all explained very well in the interview-confession given by former Director of the Italian General Directorate for Development Cooperation, Ambassador Giuseppe Santoro to *La Repubblica*, main Italian daily newspaper, in October 1992 . This interview became famous because it illustrated what for many years used to be a common practice for the Italian Development Cooperation, whose choices were not based on specific guidelines but on what Santoro called the “political need” of the moment.

“The way things worked was as follows: as the political ‘need’ arose, interventions were decided upon and plans were made, even if they were sometimes disproportionate or extremely ambitious, in order to fulfill a political goal. Then, all of a sudden, political goals were completely turned on their head due

to a change of Minister or to the appointment of a new Minister of State and so everything had to be renegotiated. These choices were not only confined to Somalia and Ethiopia. This approach was used each time in Somalia, Ethiopia, the Sahel, Austral Africa, Francophone Africa, Central America, South America, China, and the Middle

East... where agreements were continually reviewed and renegotiated”.

The costs generated by the hundreds of projects and initiatives launched on the basis of “political needs” in the last thirty years are still a burden shouldered by the South’s poor. Many people, like the communities living in the Daule Peripa reservoir, have been deprived of basic services and the right to a dignified life due to the serious impacts often caused by the projects financed in the past and the illegitimate debt accumulated over the years. This debt was incurred through actions taken not only by short-sighted and sometimes corrupt political elites in Southern countries but also by Western companies – who were always on the lookout for easy and lucrative contracts – and creditor governments, who co-designed and co-financed these projects.

The costs generated by the hundreds of projects and initiatives launched on the basis of “political needs” in the last thirty years are still a burden shouldered by the South’s poor.



Picture: view over the artificial basin a few kilometers away from the Daule Peripa dam

Within the framework of the current financial crisis and the rise of new big lenders, no tailor-made action that may be promoted by a restricted group of donors such as the Paris Club or the G8 could possibly deal with a new debt crisis in poor countries. Given this state of affairs, there is now an urgent need to engage in the topical debate on the illegitimacy of debt and bad practices that have generated it. It would also be important to take a range of actions, including comprehensive, transparent, and participatory audits on the current composition of debt – involving Italy too – and setting up some fair and transparent international arbitration process to demand debt cancellation and thus achieve economic and social justice for those who have suffered the impacts of debt and aid. At the same time, there is an increasingly compelling need to promote an array of responsible finance criteria shared on an international scale by donor governments and beneficiaries alike and founded upon principles of justice, trans-

We ask the Italian government to take a historical step and acknowledge its co-responsibility in the project, arranging a unilateral and unconditional cancellation of the debt deriving from the financing of the Marcel Laniado De Wind hydropower plant.

parency, and equity, in order to aid, as it were, the international community to “ban” those policies and bad practices which contributed to create illegitimate debt in poor countries.

Daule Peripa and the Marcel Laniado De Wind hydropower plant are a starting point and the litmus test to determine what the Italian Cooperation should not do in the future.

The Italian government, like Norway, is now being offered the chance to turn the page and admit to its co-responsibility in financing a bad cooperation project whose adverse social and environmental impacts are still felt in the life of thousands of people living in affected areas as well as among millions of Ecuadorian people who are having to repay an illegitimate debt.

We ask the Italian government to take a historical step and acknowledge its co-responsibility in the project, arranging a unilateral and unconditional cancellation of the debt deriving from the financing of

the Marcel Laniado De Wind hydropower plant. This would release funds that the Ecuadorian government could finally use to compensate adversely affected communities for the severe human rights and environmental violations suffered due to the construction of the dam and its associated power plant, as well as for all material loss and all the social, economic, environmental damage done by the project. This decision would give both governments the opportunity to launch a fair, participated process with local communities as well as with Ecuadorian and international civil society organisations aimed at identifying further actions needed at a local level. The first steps would be to drain the flooded basin,

which would eradicate the infectious diseases affecting resident communities, and create basic facilities that could guarantee these communities a dignified life.

*Campagna per la Riforma della Banca Mondiale,
Centro Legale pro Afro discendenti e Indigeni*

March 2009

Further information is available on:

<http://www.auditoriadeuda.org.ec>

<http://www.jubileo2000.ec>

<http://www.latindadd.org>

<http://www.eurodad.org>

<http://www.crbm.org>

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