

Chapter 8

Liberalisation, poverty-led growth and child rights: Ecuador from 1980 to 2000 *

Daniel Badillo, Leonardo Garnier, Jorge Enrique Vargas and Fernando Carrera with assistance from Yoriko Yasukawa, Verónica Quintero and Consuelo Carranza

Summary. This chapter aims to establish a linkage between globalisation and the capacity of Ecuador's State and society to guarantee adequate enjoyment of children's rights. The central thesis is that globalisation has had a negative affect on Ecuador's children because of the way that the country's economy has been inserted into the globalisation process. The authors emphasise that Ecuador's style of economic growth is led by production and reproduction of poverty, which is manifested both in low household income and in insufficient coverage by adequate basic social services. Moreover, the processes of opening up to trade and freeing up finance have had a negative effect on public finance, further reducing the Government's capacity to enforce children's human rights. On the basis of these premises, the chapter explores the impact of globalisation on children with an emphasis on consequences for household income and access to basic social services. The last section seeks to analyse ways in which Ecuador could overcome the poverty-led growth model, improve its insertion into the globalisation process, and thereby better satisfy children's rights.

JEL: E61, E62, G38, I31, O15

*** This study presents the views of its authors and not the official UNICEF position in this field.**

This is chapter 8 of the overall study "Harnessing Globalisation for Children: a Report to UNICEF" edited by Giovanni Andrea Cornia

1. Introduction

This article analyzes how globalization affects Ecuadorian children during one of the worst economic crises the country has ever faced. More specifically, our core purpose is to establish a linkage between globalization and the capacity of Ecuador's State and society to guarantee adequate enjoyment of children's rights in such a context.

The paper's central thesis is that, to date, globalization has had a negative effect on Ecuador's children. We explore Ecuador's style of growth, emphasizing the fact that this growth is led by the reproduction of poverty, which manifests in both low household income and insufficient access to adequate basic social services. We analyze the ways in which commercial and financial openness and liberalization have had a negative effect on both family incomes and public finance, further constraining Ecuadorian society's capacity to enforce and guarantee children's rights.

Starting with these general premises, the paper explores, first of all, the way in which Ecuadorian society fits into the globalization process, with a specific analysis of the poverty-led growth model that has characterized social, economic and political development in this South American country. On the basis of this growth pattern, the article then explores the impact of globalization on families and children, particularly emphasizing the negative impact on household income, as revealed by growing poverty and increasing inequality. The paper then goes into a more detailed analysis of public finance, its dependence on very limited and volatile revenues – oil in particular – and its impact in terms of highly restricted access to basic social services, deriving from fiscal restrictions caused by commercial and financial liberalization. The last section seeks to analyze ways in which Ecuador could overcome the poverty-led growth model, improve its insertion into the globalization process, and thereby better satisfy children's rights.

2. Background to the current crisis

2.1 Poverty-led growth

Latin American countries constitute a paradigmatic case of poverty-led growth. In general, their export-sector competitiveness has relied more on low-cost human and natural resources than on the productivity with which such resources are used. Export-sector competitiveness has also been promoted through low taxation, which has resulted in weak governments that have been politically, financially and institutionally unable to break out of the poverty cycle through social investment in key human development areas such as education and health. In the context of an increasingly global economy that demands ever increasing competitiveness, this way of competing through cheap human

and natural resources and feeble social investment and taxation, has contributed to the generation and reproduction of a markedly unequal economic, social and political structure.

Although competitiveness is a concept that should be applied and understood only at the level of businesses, it is also true that the setting in which businesses operate is a crucial element in determining their competitive strategy. Inadequate policies have so often slanted the search for profitability and competitiveness toward the exploitation of human and natural resources, toward activities with limited financial investment, simple technologies, little innovation and, consequently, toward profitability based on the perverse advantage resulting from cheap resources. This, in turn, pressures countries to keep wages from increasing, so that investments remain profitable.

This is the basis for what we call '*poverty-led growth*': poor countries with plentiful populations and natural resources try to attract the investments they believe are necessary to promote growth. The main appeal these countries feel they have for investors is precisely the abundance of very low-priced human and natural resources. To this, they then add low tax rates and evasion of social responsibilities to further attract and promote productive investment. Directly and indirectly, labor and exchange-rate policies and low taxation make these countries' poverty the main reason for their competitive advantage: companies that develop there, that invest there, will do so with technologies that will make them competitive *because of* the poor remuneration of production factors and the absence of social responsibility. The cycle of impoverishment is thus reproduced.

2.2 Historical background

Ecuador provides one of the clearest and most dramatic examples of this growth pattern that depends on and reproduces poverty: *poverty-led growth*. Acute inequality and widespread poverty have been a constant in Ecuador's economic and social evolution. The economy depended, up to the sixties, on exports of a few agricultural products (coffee and cacao at first, then bananas) and subsistence production for the small domestic market. Ecuadorian exports, over the years, have been characterized "by the predominance of two traditional comparative advantages: the availability of low-cost unskilled labor and the abundance of natural resources"¹. An additional factor was the prevalence of a very weak tax system with low tax rates, many exemptions and high evasion, which helped make companies more profitable and competitive in spite of their limited efforts to increase productivity.

During the sixties, like most countries in the region, Ecuador began promoting a process of import-substituting industrialization, including the enactment in 1965 of an industrial development law. However, it was not until the seventies' oil boom that any modernization process could pick up speed. In 1972, petroleum was nationalized and the trans-Ecuadorian pipeline was completed, enabling Ecuador to join the world of oil-exporting countries at a particularly favourable point in time. Consequently, and signaling a departure from past trends, this period was characterized by notable

¹ Larrea: p. 7

expansion of public investment, a rapid urbanization process and a broadening of urban middle-class sectors, with better salaries and subsidized access to such public services as health care, education, energy and transport².

One mainstay of Ecuador's industrial development strategy was customs-tariff protectionism, levying heavy duty on consumer goods and exonerating from or subsidizing tariffs for imports of intermediate and capital goods. A series of non-tariff barriers were also applied, such as prohibitions, prerequisite authorizations, surcharges and import deposit requirements. Another element was exemption granted according to the purpose of the imports (industrial, small industry, artisans, automotive, fishing, and so on), according to the beneficiary (broadcasting, people with disabilities, public transport) and according to the importer (National Government, municipalities, provincial councils, public enterprises). Overall, customs exemptions, tariffs and surcharges amounted to discriminatory and scattered protection, sometimes amounting to over 400 per cent of the international price of the product, which inhibited competition and contributed to this sector's inability to become truly competitive and self-sustaining.

Moreover, fiscal dependence on the taxes levied on trade did not generate enough revenues to expand infrastructure or ensure universal access to basic social services. Ecuador continued to depend on primary exports for its access to foreign exchange, agriculture was not modernized and the country's social structure remained highly unequal. The industrial sector accounted for 19 per cent of GDP by the late seventies, whereas agricultural production slumped to less than 15 per cent. Industrial employment, however, increased only from 12 to 13 per cent of the Economically Active Population (EAP), so most urban employment had to come from the services sector and, to a large degree, from informal activities.

2.3 A tendency toward financial imbalances

In the absence of a consistent and responsible fiscal policy, and despite the significance of oil revenues, major financial imbalances began to accumulate, as public spending outgrew oil earnings. From 1977 to 1981, the fiscal deficit averaged 5 per cent of GDP. Unwilling – or unable – to adjust either public expenditure or income, the Ecuadorian government turned to foreign borrowing which, in the context of excessive international financial liquidity, was theirs for the asking. This was reflected dramatically in the increasing burden of foreign debt service, which swelled from 12 per cent of GDP in 1975 to 42 per cent in 1981³.

As a result of the inflow of foreign currency brought in first by the oil boom and then by foreign borrowing, the sucre became significantly overvalued. This weighed down traditional exports and further promoted imports, which were paid for by additional

² Services expanded particularly in Ecuador's largest cities, while major rural sectors were excluded from this process of wealth generation. Therefore, inequality was not overcome, but worsened. In the long run, the difference in social opportunities between rural and urban areas led to huge migration to the cities, leading to urban poverty based on informal employment.

³ Jácome, Vos and Larrea: pp. 443-445

indebtedness, reflected in a spiraling external-account imbalance. As in other Latin American countries, this process ran dry by 1982, when the world debt crisis closed off any possibility of continuing to use the relief valve of foreign savings. Since that time, foreign debt has stifled the nation's capacity to invest and grow.

Stabilization measures were applied through the eighties to cope with the crisis, but they were neither systematic nor sufficient. The situation worsened as oil prices plunged in 1986 and also because of the effects of an earthquake that halted oil exports for more than five months in 1987. Despite the magnitude of these problems, the corresponding remedies were not applied, and financial imbalances continued to deteriorate. However, and contrary to what happened in the seventies, these imbalances entailed heavy depreciation of the sucre. This had a strong negative impact on the industrial sector, further reducing its capacity to grow and generate jobs. But it had a positive effect on both banana exports and the new shrimp-farming sector, which expanded during these years becoming – alongside petroleum – a main source of foreign exchange; although the banana industry is the only one of the three to have any significant impact as a source of employment. As a consequence, the tertiary sector – particularly informal – remained the main refuge for those trying to earn a living.

By provoking the increasing financial imbalances that led to the crisis, the failed attempt at modernization and the unfulfilled hopes of the seventies gave way to accelerating impoverishment in the eighties: “Real wages dropped, by the end of the decade, to 40% of their level in the early eighties; urban unemployment soared, with an upsurge in urban poverty. More workers concentrated in the informal sector, classified as ‘self-employed workers’, totaling over 60 per cent of the labour force and absorbing two-thirds of factorial income. Waning social spending curbed the process of improving social indicators, particularly in education and health”⁴.

2.4 Prelude to a crisis

Although most Latin American countries started to liberalize their trade systems by 1985, Ecuador waited until 1991. Then, given the crushing magnitude of the problems already outlined, and in view of the increasing pressures from the business-sector for economic policies that would create a more favourable environment for private investment, the country began to move more systematically toward liberalization and opening up to foreign trade.

The protectionist policies of the preceding period were gradually dismantled. The customs structure changed notably in 1991 with the Customs Law amendment and elimination of quotas, import licenses and subsidies, in order to make tariffs the only mechanism to shelter local production. In May 1992, the customs ceiling was reduced from 290 per cent to 27 per cent. The more than 30 tariff levels initially established were cut back to 10, moderating customs dispersion to such an extent that, by 1992, the

⁴ Ibid: p. 438

nominal tariff averaged 11 per cent⁵. Alongside this process, exporters enjoyed lower taxes on their imported inputs and capital goods, which was particularly convenient for exporters of manufactured products. Their ratio of export taxes to total production (at producer prices) dropped from 8.6 per cent in 1990 to 1.6 per cent in 1993.

The crisis of the eighties and the early-nineties' foreign trade liberalization measures resulted in a transformation of the productive sectors, with a new emphasis on exports. As a result, banana and shrimp exports performed dynamically, as did non-traditional exports such as fruits, vegetables and flowers, with major growth in textiles, seafood and vehicle exports. Also, beginning in 1994, the relative exchange-rate stability and high interest rates prevailing in the financial system attracted a major capital influx that favoured rapid expansion of banks. However, inadequate financial supervision was a prelude to the 1998 collapse⁶.

Initial success in efforts to stabilize the economy and reduce inflation had a positive impact on the incipient recovery of economic growth and the recovery of wage earners' income. Between 1991 and 1996, Ecuador's GDP rose at an annual rate of 3.4 per cent in real terms. This may not seem that impressive, but it was significantly better than the previous decade's growth, which averaged only 2 per cent per year. Inflation, which had been over 60 per cent in 1992, dropped to about 24 per cent between 1994 and 1996, and average real wages grew at an annual rate of 9 per cent. However, the rate of unemployment held relatively still at about 8.8%, reflecting the fact that some of the fastest growing sectors were not major sources of employment.

In spite of some of these positive signs, recovery was actually weak and fleeting. In 1995 and 1996, Ecuador faced a range of new problems that undermined the precarious stability and incipient growth of the first half of the nineties. The war with Peru absorbed major fiscal resources; the resignation and self-exile of Vice President Dahik, head of the government's economic team, weakened the credibility of economic reforms; an electrical crisis affected the country's productive capacity for several months; and the electoral process that made Abdalá Bucaram president promoted further uncertainty. In the following months, heightening political instability generated an impasse. Combined with exogenous difficulties (such as the serious damage done by the El Niño phenomenon in 1997, falling oil prices in 1998, and international financial crises during those years), this impasse thrust Ecuador into a new stage of profound crisis.

3. The crisis: instability, recession and impoverishment

3.1 Poverty as a starting point for the crisis

⁵ See: MULTIPLICA "Una evaluación de la política macroeconómica de los noventa" [An assessment of macroeconomic policy in the nineties]. 1998.

⁶ CEPAL [ECLAC]: 2001: p. 205

As mentioned, Ecuador had developed a pattern of insertion into the world economy that was based on the undervaluing of its human capital as the main source of comparative advantage. This had a clear impact on wages and employment of the labor force: wages tended to stagnate or even drop for lengthy periods of time, despite positive economic growth rates; and the quality of employment was also negatively affected, as high rates of under-employment and precarious employment prevailed.

Like low wages, precarious employment has also been a constant of the Ecuadorian economy. The gross rate of under-employment (informal and under-employed persons) has remained over 40 per cent for the last 10 years. This is particularly due to the enormous informal economy, absorbing nearly 35 per cent of the Economically Active Population. Precarious work is also reflected in low social security coverage, which was already low in 1988 (39 per cent of the EAP), and tended to decrease over the last 10 years, falling below 30 per cent of the EAP by 1998.

Real income for poor and middle-class sectors (some 80 per cent of the population) remained static or even deteriorated between 1988 and 1998. For the first quintile (the poorest 20 per cent) average household income maintained an average of about 7000 sucres⁷ from 1988 through 1992, rising from 1992 to 1997 in nearly 60 of these households, and finally dropping back to 1992 levels, thus losing in one year all that had been gained during the preceding five years. Middle-class sectors, by contrast (quintiles 3 and 4) earned less and less between 1988 and 1992, recovered significantly between 1992 and 1996, and finally saw their earnings drop by nearly 25 per cent in 1998. These trends suggest an economic setting in which poor and middle-class families have little chance of improving their living standards.

3.2 Dollarization: a measure of last resort

Until 1996, Ecuador had benefited from a massive influx of speculative capital that, as mentioned, resulted in rapid expansion of the financial sector. However, the crisis of international financial markets in 1997 and the subsequent Brazilian crisis provoked a devastating interruption of private external financing which, along with the appearance of a major trade deficit, generated unbearable pressure on the exchange rate. This forced the government to abandon the rate-range system in use since 1994, allowing the exchange rate to float.

Rather than floating, the exchange rate of the sucre sank from about US\$1 to less than US\$0.20 per 4000 sucres; that is, from under 4000 sucres per dollar in 1997 the exchange rate went to over 20,000 in 1999. This rapid devaluation multiplied inflationary pressures and worsened the already critical situation of the financial sector. The government attempted to attack these problems by decreeing a “bank holiday” and proceeded, in early 1999, to freeze bank deposits to prevent a run on all banks. Moreover, in view of the increasing likelihood of a generalized financial crisis, 14 banks were taken over and restructured, including some of the largest, totaling nearly 70 per cent of the overall financial system.

⁷ Income data are given in 1988 sucres.

Government intervention, while unable to stem exchange-rate devaluation, accelerated inflation to over 60 per cent per annum in 1999, seriously affecting productive activities. GDP dropped in more than 7 per cent in 1999; the rate of unemployment, which had been 9.3 per cent in 1997, rose to 15.1 per cent in 1999, whereas underemployment soared from 43 to 57 per cent, as the number of people taking refuge in informal activities grew.

By late 1999, the situation became more complicated on practically every front. Although fiscal accounts (like external accounts) benefited from oil price increases, this was not enough, since the rapid devaluation of the sucre led to a rapid increase in the burden of public foreign debt. Additionally, attempts to cut public spending through the elimination of subsidies failed in the face of ever-more vocal public protests. In trying to cope with this complex and worsening array of problems and recover some degree of legitimacy and credibility, the government announced, in early 2000, the dollarization of Ecuador's economy. Public dissatisfaction, however, had reached levels that made such a measure hard to implement, since dollarization was perceived as a mechanism that would hit grassroots income hardest. Protests increased to the point of forcing President Mahuad to step down. His Vice-president, Gustavo Noboa, formed a new government.

3.3 Poverty as a result of the crisis

Paradoxically, while dollarization precipitated the forced resignation of President Mahuad, the new government under Noboa maintained the decision to dollarize the economy, which was implemented during the first quarter of 2000. An exchange rate of 25,000 sucres per dollar was set and the Law for Economic Transformation of Ecuador (nicknamed the "Trolley Law") was enacted, establishing a series of monetary, exchange, fiscal, structural and labour reforms to go along with the transition to the new monetary system.

The crisis continued throughout 2000, albeit with a trend towards stabilization by the second half of the year. The real wage index produced by the Central Bank of Ecuador makes it possible to conclude that the greatest decline in real wages happened between September 1999 and June 2000. After that point, however, the real wage index appears to recover to almost the pre-1998 level. This positive sign would seem to be supported by a decrease in the unemployment rate in Ecuador's main cities (Quito, Guayaquil and Cuenca), from 17 to 11 per cent between January 2000 and January 2001. Both the recovery in wages and decreased unemployment reflect an economic climate of greater certainty, which has had a positive affect on investment levels since mid-2000, after dollarization came into effect. However, a more detailed analysis of employment indicators for the second half of 2000 reflects a substantial increase in under-employment of the EAP, particularly in invisible under-employment. This would indicate that people found work at salaries below the minimum wage. Moreover, apparent improvement in the real wage index should not conceal the fact that inflation has been very high over the last two years, with a cumulative rate of 61 per cent in December 1999 and 91 per cent in December 2000, but not all prices rose at the same rate. During 2000, the main factors boosting prices were food, beverages and tobacco (an increase of 121 per cent); clothing

and footwear (119 per cent); health-care services (113 per cent); and furniture, equipment and home maintenance (115 per cent). These items represent peoples' basic needs and account for most of poor people's expenditures. Therefore, the poorest people have been those most affected by the price increases.

The impact of this crisis on the Ecuadorian people as a whole cannot be overstated. The number of people living in poverty, always high, more than doubled as a result of the crisis, from 3.9 to 8.3 million, i.e. two-thirds of the population. Children have been hit the hardest by this dramatic and very rapid impoverishment. In 1995, 37 per cent of Ecuadorian children lived in poverty. By the year 2000 poverty was estimated to affect 75 per cent of them. Worse yet, not only has poverty spread, but it has become more intense: the poor are now poorer, with 25 per cent less real income. And social spending per capita has also dropped in such important areas as education (22 per cent lower) and health (26 per cent lower), further reducing the ability of poor families to meet even their most basic needs⁸.

4. Globalization and crisis: their compound impact on public finances

4.1 The fiscal impact of liberalization and deregulation

As mentioned, in the context of import-substitution strategies, customs duty was the main tax-related source of fiscal revenues in Ecuador from the sixties into the eighties. In the nineties, however, as foreign trade was liberalized, the value-added tax (VAT) became the main fiscal financial resource. In fact, prior to the commercial opening up process, customs duty accounted for 30 per cent of all taxes; by 1996, falling to 18 per cent by 1996. As a proportion of GDP, customs duty was 2.8 per cent in 1985 – twice the proportion represented by VAT and income tax together. By 1996, the situation had reversed: customs duty was only 1.3 per cent of GDP, versus 3.3 per cent for VAT. Changes in the tax structure and the lesser fiscal role of customs tariffs reinforced the regressive trend of the poverty-led growth model. The turn to financing based on consumption tax (VAT) rather than income tax and customs duty establishes a fiscal structure that charges companies less and middle-/lower-class families more. At the same time, these changes in Ecuador's trade and fiscal policy meant a substantial reduction in fiscal revenues. Whereas customs tariffs averaged nearly US\$300 million a year in the mid-eighties, this dropped in the first years of opening up to about US\$190 million, making the fiscal loss nearly US\$110 million a year, the equivalent of 0.8 per cent of GDP and almost as high of the total fiscal deficit, which was 1.1 per cent of GDP in 1992.

The promotion of non-traditional exports (seafood products, flowers, asparagus, broccoli, vehicle assembling, etc.) that went hand in hand with trade liberalization meant an

⁸ UNICEF: "Características de la Pro-Forma Presupuestaria y del Gasto Social para el 2001" [Characteristics of the Proposed Budget and Social Spending for 2001], Adjustment with a Human Face Series, UNICEF, Quito, 2001, p. 1

increasing demand for capital goods and imported raw materials. By the late nineties, in the context of waning international prices for oil and other primary products – and, therefore, worsening terms of trade – this increased demand for imports made it necessary to use foreign borrowing to compensate for the shortfall in external accounts⁹. At the same time, both public and private savings fell short of the financing needs of public and private investment, making it necessary to look abroad for funds. This weakness of domestic savings was a typical result of the poverty-led growth model. On the one hand, low taxation prevents governmental investment and saving, which is even more damaging because of the regressive distribution of income that prevents the generation of savings in middle- and lower-class sectors. On the other hand, poverty-led growth stimulates the consumption of luxury goods and, thus, a foreign-currency drain in the highest-income sectors.

Given the increasingly global character of financial markets, the process of financial liberalization and the sharp decrease in exchange-rate control encouraged speculative capital influx into Ecuador. This evolution maintained fiscal dependence on oil revenues while adding the volatility of the international capital flows, along with the possibility of recurring international financial crises. Therefore, the possibility of weathering external imbalances, or just the appearance of such imbalances, was deeply rooted in the capacity to obtain resources on the international financial market.

Beginning in January 1993, interest rates for lending and borrowing were set free, and there was an effort to increase the transparency of financial information and the efficiency of the financial system. In May 1994, the General Law on Financial System Institutions prompted the country's actual financial liberalization process by providing a legal and institutional framework for financial system modernization and deregulation. Above all, it partially liberated the flow of capital into and out of the country. It also attempted to homogenize and reinforce bank supervision and regulation mechanisms to adapt them to internationally accepted standards. This financial liberalization, along with the constant need for external financing, soon established new rules for Ecuador's economic policy and particularly for the complex, delicate management of some of its key instruments: national interest rates, international interest rates and exchange rates.

First of all, as already analyzed, financial liberalization meant a radical move in terms of *exchange-rate policy* i.e. dollarization. This, as implemented, also meant a drastic devaluation that encouraged the capital influx necessary to finance the growing external and public deficits. It also meant a drastic redistribution of income benefiting those who had either their incomes or their savings in dollars.

Second, holding *interest rates* high, a necessary but insufficient condition for attracting external capital, weakened public finance and banks and relegated productive investment. This made public finance more vulnerable, by pressuring the fiscal deficit in two ways:

⁹ This is also rooted in the abortive development of Ecuadorian industrialization, reflected in the national production system's inability to provide the necessary capital goods and raw materials demanded by the dynamic sectors, which makes it necessary to import them from elsewhere.

(i) by making domestic debt service more costly (most of it borrowed on a floating-rate basis under short-term dollar-indexed securities); and (ii) by curbing fiscal revenues, making investors nervous about the possibility of a further devaluation (before dollarization) or refusal to pay by authorities. This also weakened banks by encouraging them to grant loans to bad-quality customers, thereby increasing the risk of bad debts. It also increased their vulnerability through rapid liberalization of financial markets and increasingly risky lending, when deposits failed to grow at the same rate as the increase in the interest rates they paid, calling for capitalization.

Moreover, high interest rates considerably increased the cost of borrowing for companies and households. This led to a drop in productive investment projects, as financial investment came to the fore, at the expense of growth and employment, thus pushing the economy as a whole into a process of financial speculation, with appalling results. As long as this economic trend awakened no fears of bankruptcy in economic stakeholders, deficits could be covered by fresh capital influx. However, once deficits got out of hand and capital stopped coming in, the growing financial stability quickly precipitated a banking crisis.

This banking crisis was symptomatic, revealing that the country as a whole was, in effect, bankrupt as government, banks, companies and households all became insolvent. The bank crisis absorbed huge amounts of fiscal resources to cover the cost of bank bailouts, which totaled 30 per cent of GDP. It shifted huge amounts of wealth from middle- and lower-class sectors to a small group holding dollars – the bankers and beneficiaries of liquidity loans from the Central Bank. Then, the freezing of the public's deposits in the banking system – which totaled US\$ 3.8 billion – slashed by a single pen-stroke the disposable income of the vast majority of Ecuadorians, benefiting the small number of bankers who had already disposed of these deposits of other people's money. Finally, the granting of liquidity loans by the Central Bank to this same group of bankers was also a sizable sum. The direct liquidity loans granted by the Central Bank to other banks totaled US\$ 900 million, while the exchange of bonds delivered by the government to the Deposit Guarantee Agency (AGD) for Central Bank money was another US\$ 1.3 billion.

This forced the government to issue a very significant amount of money. It is estimated that the monetary aggregates grew by over 150 per cent in 1999, with consequences for inflation and devaluation. These actions totaled US\$6 billion. To put this amount in perspective, it was the equivalent of thirteen years of the national budget for education and culture, 39 years of the health budget, or 70 years of the solidarity bonus.

4.2 Oil and the vulnerability of Ecuadorian public finance

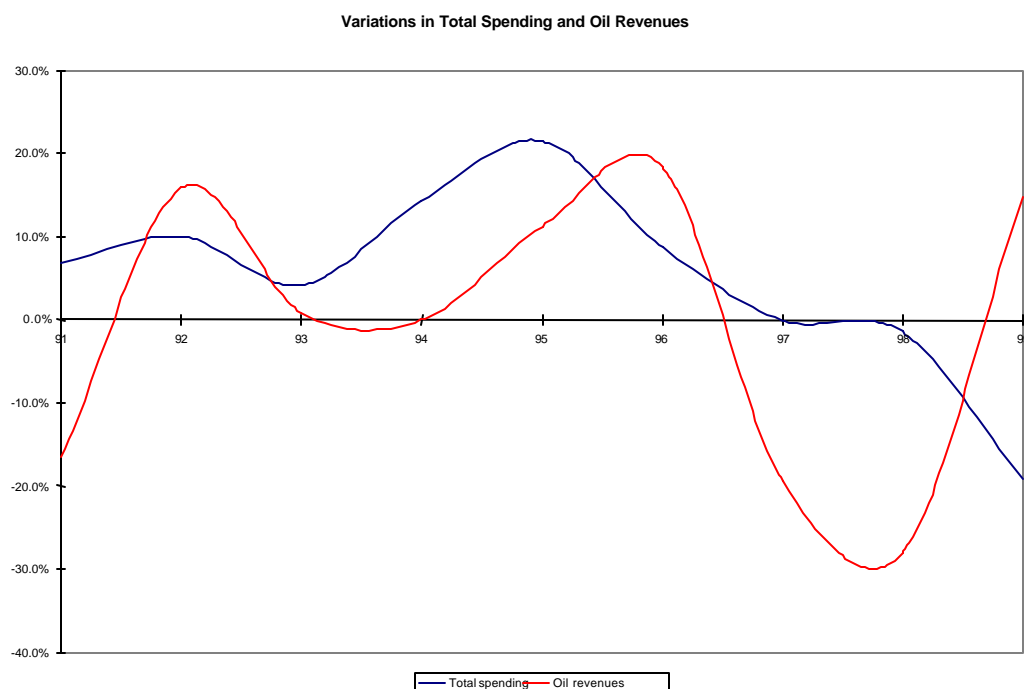
The fiscal implications of Ecuador's trade opening and financial liberalization must be analyzed within a public financing structure that has depended for three decades on highly volatile oil revenues. In the 1980s and 1990s – as mentioned – fluctuating oil revenues had a strong affect on fiscal incomes as, for example, in 1998 when oil prices plummeted, bottoming out at US\$9 a barrel, or in 2000 when they hiked to over US\$25. Thus, in 1998, over 52 per cent of total fiscal revenue decrease was due to reduced oil earnings while, in

2000, over 70 per cent of enhanced fiscal revenues was due to increased oil earnings. In addition, adjustments in domestic fuel prices (basically for gasoline) acted also as a new and important source of fiscal revenues from petroleum activities, even topping crude-oil exports in some years. In 1990, revenues from domestic fuel sales were only 16 per cent of total petroleum revenues, but they were 73 per cent in 1998 and 57 per cent in 2000.

By the year 2000, the level of oil dependence meant that oil revenues accounted for 50 per cent of total government income, representing 9.5 per cent of GDP. As the Economic Commission for Latin America and the Caribbean (ECLAC) has argued for other oil producing countries in Latin America¹⁰, access to this type of revenue usually allows governments to continue neglecting an adequate and responsible tax policy as a constant, stable way to fund the national budget. In 1999 taxation only amounted to 10 per cent of GDP in Ecuador, having remained below 7 per cent for years – one of the lowest levels for Latin America.

This makes the national economy – and public finances in particular – highly vulnerable to sudden exogenous shocks, such as difficulties in production, transport and/or refining of crude oil, or abrupt changes in international prices or domestic or foreign demand. Heavy dependence on fiscal earnings from petroleum and the high volatility of such revenues have meant, therefore, that public spending is also highly volatile. Variations in public spending resulting from variations in oil revenues show a high degree of correlation, with a certain time lag. When oil earnings have waned, public spending has followed them down; and, when oil income has risen, public spending has recovered. Petroleum revenues have a pro-cyclical effect on public spending as shown in figure 1.

¹⁰ See "El Pacto Fiscal: fortalezas y debilidades" [The Fiscal Pact: strengths and weaknesses], Síntesis, Santiago, Chile. April 1998. Appearance of oil revenues introduced a "particular attitude" in Ecuadorian economic and social stakeholders that is characteristic of economies based on tapping resources. The country has become enriched not through work but by the relationship of forces, since stakeholders' involvement in this enrichment depended on negotiation. The sphere of circulation prevailed over production, so any economic surplus produced would be minimized and enrichment would come from the capacity to take part in the petroleum revenue circuit. The primary aim of production was not, then, to generate an economic surplus, but to commandeer part of the revenues and legitimacy to obtain it by developing political patronage. For this reason, revenues based on resource exploitation are considered anti-productive and highly prone to corruption.



a. Figure 1

4.3 The fiscal meaning of dollarization

By eliminating monetary and exchange-rate policy as available means to neutralize the effects of diverse financial disequilibria, dollarization significantly alters macroeconomic regulation and crisis management instruments. In the future, crisis management of either external or internal shocks must be addressed simply through fiscal policy and through the capacity of production and employment to adjust to the crisis. Indeed, when the exchange rate is fixed, although this stabilizes a series of nominal prices, at the same time it restricts part of the economy's capacity to react to shocks – and these shocks can occur anyway. Therefore, as monetary variables are insulated, these shocks will manifest themselves in other areas of the economy that must, in turn, become much more flexible in order to confront such shocks. If excess spending cannot be adjusted through a change in relative monetary pricing (devaluations), then excess spending will have to be adjusted through changes in the level of economic activity. And this real-world adjustment will, of course, have staggering implications in the social realm.

Therefore, as fiscal policy becomes the main instrument of economic policy, public finance assumes a new nature and role. This calls for new instruments to help palliate possible shocks or compensate for rigidities generated in relative pricing, on the one hand, and flexibilities generated in production and employment, on the other.

4.4 An impoverished government: another consequence of poverty-led growth

As a result of the dynamics of poverty-led growth, and stimulated by the illusion that oil revenues will take care of everything, Ecuadorian society has not been accustomed to paying taxes. It lacks a “taxpaying culture” and, therefore, tax-collection rates have always been very low. Such limited, volatile and insecure fiscal revenues as have been typical in Ecuador, led – as described – to recurring fiscal deficits in the 1980s and 1990s, despite significant public spending cutbacks. Beginning in the mid-1990s, these deficits reached levels of around 3 per cent of GDP rising to 6 per cent by 1999. At first, this structural deficit was financed through a ballooning public debt, but that momentary relief soon became another unbalancing factor. Whereas in 1990, domestic public debt was almost nonexistent, accounting for merely 2 per cent of GDP, it grew exponentially from that point on, and by 1999 it represented 24 per cent of GDP. As for external public debt, the situation was even worse, as it reached 99 per cent of GDP in that same year. Servicing of both domestic and external public debt resulted in further fiscal imbalances, drastically reducing the capacity of the Ecuadorian government to carry on with its programmes.

The tragic magnitude of this problem became apparent in the public budget in 2000, when nearly 77 cents of each dollar entering the treasury from taxes and from petroleum revenues had to be used to service the public debt, leaving only 23 cents for social and non-social spending. Since this scanty balance was obviously insufficient to cope with the State’s basic expenditures and responsibilities, the government had no option but to keep on borrowing to cover for its already limited expenses, thus completing a vicious circle of indefinite over-indebtedness.

5. The increasing insufficiency of public social investment

5.1 Low priority for social expenditure

Given the low incomes and precarious employment prevailing in Ecuador, one obvious way to improve living conditions would be to guarantee better social opportunities for children and youth through access to basic social services. Historically, however, the dynamics of poverty-led growth not only meant meagre incomes for large sections of the population, but the crippling of the Ecuadorian government – which has the foremost responsibility to ensure such services – so that it has not been able or willing to allocate sufficient resources to the necessary social investments. On the contrary, downsizing and the reduction of social spending in key areas – like education and health – have often been instrumental in balancing public budgets during fiscal adjustments in times of crisis.

An analysis of public investment in education from 1972 to 1995 reveals, for example, how this investment had averaged nearly 4.5 per cent of GDP during the seventies and eighties but decreased gradually after 1989, reaching an all time low of approximately 3 per cent of GDP – a contraction of nearly 30 per cent. Public investment in health has

been minimal in Ecuador over these last three decades, averaging about 2.0 per cent of GDP and dropping as low as 1.5 per cent of GDP during the second half of the seventies and the first half of the eighties. Measured in per capita terms, these tendencies appear even clearer. In both health and education there were significant increases in per capita investment from 1972 through 1982, which were then followed by prolonged and severe reductions from 1983 through 1994, so that such investments receded by nearly 50 per cent in health-care, and over 60 per cent in education. Such feeble social investment coincided with a period of major fiscal restrictions on the Ecuadorian government (1983-1994), and the worst social spending cutbacks occurred at times of greatest economic pressures, particularly in 1990 and 1991. This means that the Ecuadorian governments' commitment to valuing and developing human capital – which could redefine the way that Ecuador inserts economically in the globalization process – has been, at best, tenuous.

In terms of access to these social services, net school enrolment rate held steady at nearly 95 per cent during the 1990s. Although this sounds positive, it is an average – concealing the fact that waning funds for education have curtailed the expansion of educational services into remote rural areas. Similarly, coverage of immunization has ranged from 80 to 90 per cent, but with ups and downs that indicate that coverage is more the result of isolated efforts, such as vaccination campaigns, than an ongoing institutional approach. This lack of institutional support may also be partially attributed to the chronic lack of funding for the health sector. Another major indicator is the rate of childbirths in health-care institutions. Although no consistent statistical series are available for this indicator, the 1995 figure clearly reflects how things have been for the last decade. In rural zones, 44 per cent of babies are still delivered at home, without any professional health-care personnel present. While the situation in urban zones is much better, 9 per cent of babies are still born at home (although, in urban childbirths, the assumption of no professional health-care personnel present may be inaccurate). Moreover, although nearly 14 per cent of children under the age of five suffer from malnutrition¹¹, only 2 per cent of children have received free food supplements in recent year. Again, the lack of funding for the health sector seems to have affected the Ecuadorian government's capacity to meet children's basic needs.

Restrictions on wage increases have eroded workers' income in the social sector, particularly for teachers and health-care workers. This has meant that the corresponding institutions and ministries have worked with decreasing budgets, but without having to close schools or health centres, or dismiss personnel, because salaries have also dropped. As a consequence, the impact of such financial setbacks cannot be seen immediately in terms of actual coverage, but tends to affect the quality and effectiveness of those programmes in the long run. This long term effect is also related to a steady transformation in the structure of social spending, with education losing relative and absolute weight in favor of programmes for direct transfers to the population. This move finds institutional expression in the significant strengthening of the Ministry of Welfare, which is responsible for social compensation programmes, particularly the so-called solidarity bonus, vis a vis other social ministries, like those of Education and Health.

¹¹ This indicator refers to overall malnutrition.

5.2 Mismanagement of social programmes

Given the dramatic scarcity of resources for social investment, and the equally dramatic significance of those investments both for human well-being and for economic growth, one would hope that these scant resources were handled with extreme efficiency and care through the social service delivery system. Unfortunately, that has not been the case. Inflexibility in public finance and reduced social spending during the eighties and part of the nineties severely undermined the institutional capacity acquired by the social sector during the seventies, rendering the social sector incapable of confronting the effects of the crisis. The country's different social entities were too weak to protect the vulnerable population during the crucial phase of transition toward a new monetary model that aimed to promote situations of conflict and social crisis; too weak to enforce constitutional guarantees of rights; and too weak to preserve and increase the reserve of human capital, so harshly pressured over the last few years. The State is still the main player in providing basic social services, especially in the areas of health, education and social security; however, governmental management and administration of social service delivery systems have been poorly organized, both in terms of actual service provision and in the allocation of funding in order to address current challenges and needs.

The provision of educational and health-care services is centralized. This means, on the one hand, that schools, health centres and hospitals depend directly on ministries and, on the other, that the functions of actual service delivery (such as the selection of the array of inputs and their administration) are performed within central ministries. Decision-making about service provision happens far from each school or hospital, which makes it extremely difficult to manage, obtain basic feedback, make decisions, or provide incentives for health and education systems. Operational units have no flexibility to respond rationally to their users' needs, to changing circumstances or new opportunities and they have little or no autonomy for decision making. Users have few options regarding the facilities and services they do – or do not – receive, with relatively little participation in providing information or feedback to schools and hospitals about their needs, satisfaction or dissatisfaction. This yields little incentive to service providers to be responsive to their users' needs or to improve service.

Mechanisms to allocate resources to social service providers (schools, hospitals, health centres, etc.) are so rigid that they are highly inefficient and inequitable in implementing this spending. The current system delivers financial resources to each school or hospital on the basis of previous allocations, its size, the number of classrooms or beds, the number and classification of teachers and doctors, rather than according to the actual results that each school or health centre (service provider) achieves, or the demand that it satisfies. This approach to resource allocation completely insulates the results achieved by schools and health centres (well-educated students, healthy patients) from the income they receive, meaning that service providers have very little incentive to increase the quantity or quality of their efforts, since their funding is totally disconnected from their productivity or performance. Schools and health centres receive their fixed budget at the end of each month, whether they work hard and well, badly, or not at all.

The perverse impact on social spending resulting from the way in which public finances have been traditionally handled – and, particularly, from the way in which they have been *adjusted* during times of crisis – was compounded by the equally damaging effect of the drained institutional capacity of the social sector. Both the reduced amount of resources allocated to social programmes and the weaker institutional capacity of the social sector, are elements that result from and further reproduce the dynamics of poverty-led growth, negatively affecting the living conditions of Ecuadorian children, keeping public finance away from opportunities to enforce children’s rights and curtailing the formation of human capital that would be essential for a different kind of economic growth – one that is compatible with human sustainable development.

5.3 The further contraction of social expenditure and investment

The tendency to use social spending as a convenient instrument for adjusting public budgets in times of crisis was all but confirmed in the late 1990s. As over-indebtedness increased the burden of an ever increasing debt service, it came to displace already feeble social spending from the public budget.

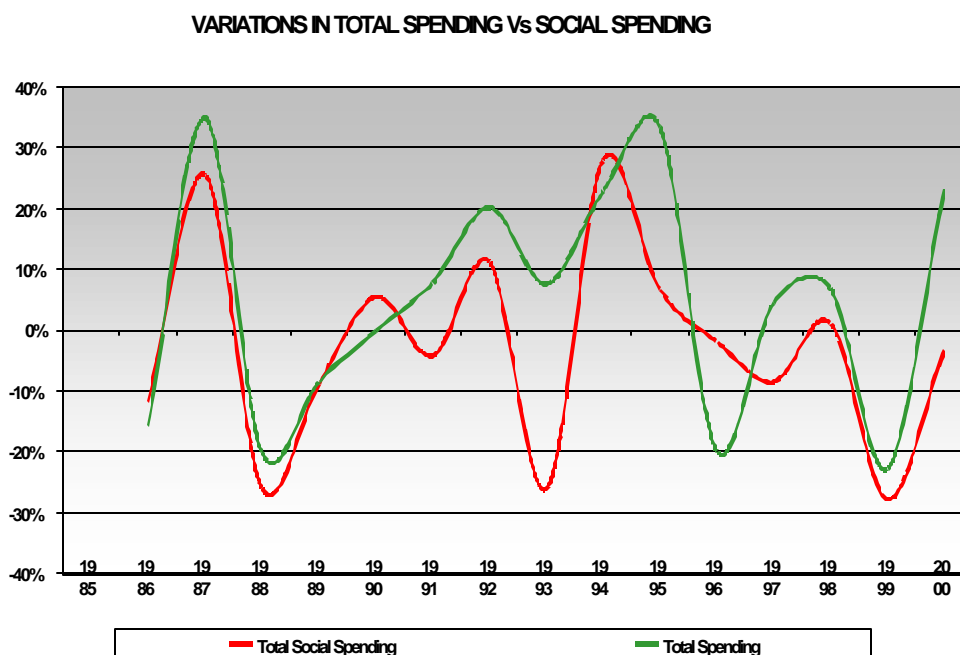


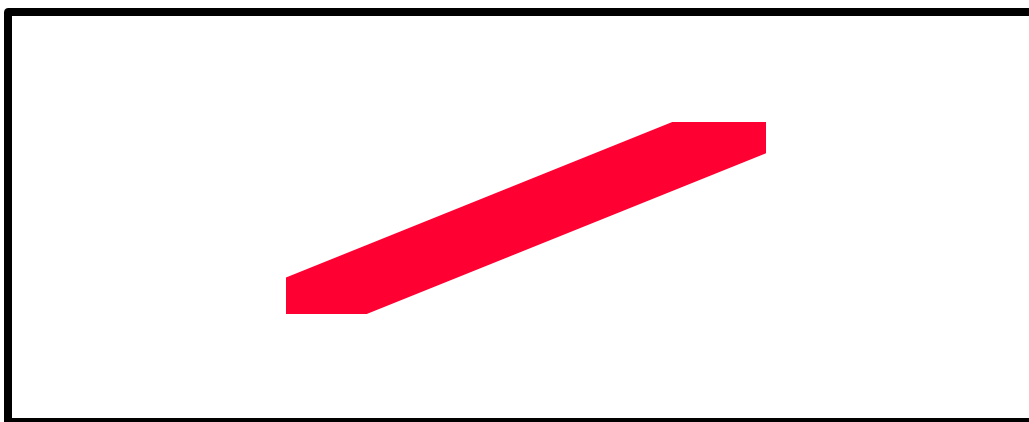
Figure 2

An analysis of central government social spending during the nineties vis a vis total central government spending, reveals a very high correlation as shown in figure 2. Social spending falls and grows in step with total public spending, but with a twist. Downward adjustments are always sharper for social than for total public spending, while they are weaker in periods of expansion, when total expenditures outgrow social spending. Moreover, during the second half of the nineties, social spending followed a continually

decreasing trend, that even the establishment of the Solidarity Bonus was unable to reverse. As a result, there was a slight reduction in the macroeconomic priority of social spending, as reflected in the ratio of social spending to GDP, which went from 5.2 per cent to 5 per cent between 1996 and 2000; and a clear reduction in its fiscal priority, as the proportion of social spending in total spending for the general national budget fell from 20 to 16 per cent in the same period. As a result, per capita social spending by the central government fell from US\$100 per person in 1996 (US\$83 excluding spending on social security) to US\$72 in the year 2000 (US\$55 without social security). This is a major setback that, compared to other countries of the region, puts Ecuador at the very low end, even below Bolivia and Peru. On the contrary, such countries as Chile and Costa Rica, with both higher human development and economic growth, spend between US\$500 and US\$700 per person per year, that is, 7 to 10 times more than Ecuador¹².

The low taxation rate characterizing public finance, the high percentage of the national budget absorbed by public debt service (both foreign and domestic), the fiscal cost of the bank crisis for the national budget, and the heavy dependence of public finance on highly cyclical oil revenues, all come together to define the Ecuadorian government as a “Minimal State” in terms of its actual capacity to finance and implement its various responsibilities, particularly those related to investment in human capital and physical investment. This vicious circle rolls on inexorably, as reducing State capacity implies an undermining of State legitimacy, encouraging, in turn, a culture of tax evasion that generates further deficits that must be covered by increased borrowing.

Figure 3
ECUADOR'S BUDGETARY SITUATION IN 2000
(Millions of US dollars)



¹² See Mostajo, R. "Gasto Social y distribución del ingreso: caracterización e impacto redistributivo en países seleccionados de América Latina y el Caribe" [Social Spending and distribution of income: characterization and redistributive impact on selected countries of Latin America and the Caribbean]. CEPAL [ECLAC], Economic Reform Series N° 69, May 2000

The budgetary situation of 2000 was very revealing. Revenues of US\$2591 million – of which 44 per cent came from oil – were clearly insufficient to finance that year's budget: 77 per cent of those revenues went to service the public debt, leaving only 23 per cent – that is US\$596 million – for everything else. Just how insufficient this was can be seen from the fact that it accounted for only 32 per cent of the government's planned expenditure for that year, which meant that the rest – 68 per cent – had to be financed through new debt amounting to US\$1279 million. Over-indebtedness ultimately crowds out social spending and the financing of public investment that is essential for growth. No country that has to spend over 70 per cent of its revenues on debt servicing can meet its people's social needs or sustain its economic growth; the debt burden further prevents public investment in key areas to reactivate growth drivers: human capital and public investment. The unbearable cost of debt service, the fiscal cost of the bank crisis and low tax revenues prevent the public sector from investing in decisive areas for economic reactivation and the recovery of sustained growth.

The resulting investment in human capital falls far short of what would be necessary in order to transform the quality of the labour force, but it also falls short in terms of meeting the people's most pressing social needs. Over the last few years, public social investment has been fading away. It is estimated that, were the central government to effectively attend to the basic social needs of the population, its social expenditures ought to double from current levels up to 10 per cent of GDP. This means that, in order to fund this investment with sound and certain revenues, taxation should increase from less than 10 per cent to over 15 per cent of GDP – which is highly improbable given both the historical tendencies and the current conditions.

The very limited resources available to fund social spending, in general, have also constrained investment in the most basic social services. Basic social services (BSS) for sustainable human development – nutrition, basic education, primary health care, safe water supply and sanitation – are very cost effective investments as they are low-cost and yet produce a high impact in terms of people's living conditions. However, although these services are recognized as determining factors for human development, they only received nine cents on the dollar from the year 2000 budget. Although investment in basic social services had already been limited, it fell even further: from almost US\$900 million in 1998 to just over US\$600 million in 2000. Even this figure was slightly higher than the figure for the previous year – making 1999 the worst year in the last decade.

Because of delay in the release of social statistics, it is difficult to assess the impact of such restrictions on actual access to basic social services during the last two years of the 1990s. Furthermore, even if data were available, such effects would be at least partially offset by the resilience and survival strategies of the population, as reflected in the ability and the will of families to protect their children's well-being even in the harshest environments. With these caveats, we can look at some partial and indirect indicators.

Apparently, the net rate of schooling fell three points between 1997 and 1999 (from 96 to 93 per cent according to urban employment and unemployment surveys). However, this contrasts with the apparent decrease in children over age 10 who work but do not study,

an indicator that has decreased from 19 per cent (1995) to 17 per cent (1999)¹³. Immunization coverage does seem to have been affected by restrictive financial conditions, since surveys suggest a major decrease in 1998 and 1999. Whereas 1997 vaccination coverage was 94 per cent nationwide, coverage figures for 1998 were 86 per cent, falling to 81 per cent for 1999. This negative trend affects mainly the regions of the Highlands and Amazon basin, although figures in the Coastal region also declined. Another indicator affected is coverage by programmes providing free nutritional supplements, which dropped from 4.5 per cent coverage in 1995 to only 2 per cent in 1999. This affected, in particular, children living in the Highlands, where food supplement programmes dropped from 5 per cent coverage (1995) to 1 per cent (1999). However, these figures contradict a decrease in overall malnutrition from 1998 to 1999, for children under the age of five, which dropped from 14.6 to 13.5 per cent.

6. Can we cope with globalization through poverty-led growth?

As we have seen in previous sections, the pattern of poverty-led growth that has been characteristic of Ecuador's history generated both low income levels for households and low social investment on the part of governments. Both aspects have had a direct impact on children's well-being, making it impossible for them to effectively exercise their right to an enjoyable and fulfilling life. In that context, globalization has come to reassert the dynamics of poverty-led growth, as it has reinforced the regressive alliance of internal and external forces pushing for the preeminence of narrowly-interpreted economic efficiency, that is, efficiency from the standpoint of markets and financial profitability. Thus, slower growth has not been accompanied by more public investment, but by less, and with less emphasis on redistributive programmes. The picture that emerges is bleak, as those institutions that are supposed to protect society from the unfettered workings of the market, are the same institutions that are being weakened by globalization.

6.1 Breaking out of poverty-led growth

Globalization confronts businesses in every country – and Ecuador is no exception – with the challenge of global competitiveness. However, as already mentioned, while competitiveness refers to decisions at the business level, the setting in which businesses operate determines their competitive strategy. One strategy, for example, is to produce high-quality, low-cost goods through high productivity, based on modern management and use of scientific and technological expertise, to enhance the productive capacity of a country's human, natural and financial resources. The threat is that, in countries like Ecuador where acute inequality prevails, where poverty predominates and where people's productive potential is limited, there is an opening for a very different strategy, which ECLAC has termed *spurious competitiveness*¹⁴. In this strategy, low prices of exports are

¹³ It is important to note that these figures are from Living Conditions Surveys and are therefore not directly comparable with the previously mentioned net school enrollment rate.

¹⁴ CEPAL [ECLAC]: *Transformación productiva con equidad* [Productive transformation with equity] United Nations, Santiago, 1990, p. 80

not grounded in a systematic effort to enhance productivity, but in continued access to very cheap human and natural resources. In the former case, prices reflect the economy's high productive capacity; in the latter, they reflect only the poverty of its productive resources. In both cases, companies can be competitive and profitable, but in the former that competitiveness is accompanied by a country's development and the increasing well-being of its people; in the latter the competitiveness is bogus, and companies achieve it by sacrificing the rest of society.

One of the most important elements for breaking out of the cycle of poverty-led growth lies in developing people's capacities to participate in highly productive processes. This calls for greater knowledge and skills, better organizational and administrative capacity, greater willingness and ability to use technology and, in general, the development of a solid modern culture¹⁵. The challenges of universal, relevant, high-quality basic education combine with the need for different processes of technical, professional and scientific education, without which a country like Ecuador can never hope to participate successfully in global markets.

But raising the potential of human capital is not enough. The history of Latin American countries – and of Ecuador in particular – has been characterized by a failure to establish adequate linkages between social and economic aspects of human development. Thus, the burden of history may prove to be a heavy source of inertia against such linkages. To prevent that inertia from prevailing, then, it is also necessary to transform the country's institutional setting to enable and encourage increased productivity – and not low wages – as the main source of competitiveness for businesses. To move forward in this direction, a country needs a bold and vigorous social policy. This should not just compensate or provides relief for social problems caused by economic crisis or adjustment, but make sense in its own right, by raising the people's quality of life and becoming the indispensable prerequisite to motivate, spur and even '*threaten*' firms, forcing them to abandon spurious competitiveness based on low productivity, low wages and low taxation. Such a policy must guarantee access for the entire population to such services as education, health, housing and environmental sanitation, since they are the foundation for both the quality of life and the productive capacity of the population.

The magnitude of resources called for by the required social investment is far beyond what has been considered '*reasonable*' to spend on social programmes in countries like Ecuador. This has been acknowledged by the ministers of finance in Latin America who, realizing that the levels of social spending are insufficient to meet the people's needs and become true social investment, stated that:

Postponing social investment policies that will expand and empower human capital is no longer just an ethical failure, but an economic mistake that cheats society of its main resource for adapting to the rapid incorporation of technical progress into productive processes. Social

¹⁵ The idea is not to 'import' cultural patterns and superimpose them on local culture; that is not desirable and won't work. The idea is to broaden the people's cultural patterns, incorporating, on the basis of local culture(s), those features of universal culture (or particular other cultures) that are deemed conducive to development.

investment nowadays is a key element to building the society that we will be tomorrow¹⁶.

6.2 Where is Ecuador headed?

It is accurate to say that the crisis – including the subsequent adjustment – is the consolidation of poverty-led growth in Ecuador, through the effective devaluation of its human and natural resources.

From the standpoint of those who support a strategy based on such devaluation, the crisis should open the doors to a reactivation of Ecuador's economic model, promoting the emergence of new exports that, in turn, will provide the foundation for a re-establishment of economic stability and growth. Logically – as we have argued – the type of investments most likely to be attracted by this devaluation would be those whose profitability depends on the low unit cost of productive resources. This could produce stability and growth, yes, but stability and growth at a “low level”¹⁷. It will offer no hope of significant improvement to household incomes, much less to the development of a social investment system that would guarantee both improved quality of life for the people as a whole and the development of their productive capacities – human capital. It would be, again, poverty-led growth that would consolidate poverty and widen existing inequalities.

But things could be even worse. If, despite the devaluation of national productive resources, investment does not increase at the expected pace for this new model to get up and running, then both firms and the people will have to start finding their own escape routes. If investment opportunities fail to materialize, if new jobs are not created even at the prevailing low wages, then not only firms, but even workers themselves will have to go elsewhere, to find work in other places, in other countries, at wages that, although low by international standards, at least allow them to survive and send some money to their families back home.

This forces upon us a dramatic question: will Ecuadorians themselves be the new non-traditional export – the new oil boom – that provides the foreign exchange that their country needs to pay for its commercial and financial obligations, for its imports and debts? The impressive increase in migration in the last couple of years would suggest that this scenario is more than a mere possibility: it is becoming a reality. This means that Ecuador must take up, as a matter of urgency, the essential tasks required to minimize the problems that could be caused to the social fabric by migration, and at the same time, take advantage of the window of opportunity that may be opened by migration.

The transfer of money from migrants to their families have already become Ecuador's second-largest source of foreign exchange, after petroleum, It is estimated that, during 2000, money transferred home totaled US\$1.185 billion, almost half as much as oil

¹⁶ Declaración de la III Reunión Iberoamericana de Ministros de Economía y Hacienda [Declaration by the Second Meeting of Latin American Ministers of Economics and Finance], Panama City, September 2000.

¹⁷ Cfr. UNICEF: Ajuste con Rostro Humano... [Adjustment with a human face ...]

revenues, and more than the earnings from banana and shrimp exports together. Unofficial estimates put the number of Ecuadorians who migrated in 2000 well over 164,000, mostly to Spain, where there may already be half a million Ecuadorians¹⁸. How can we avoid wasting these revenues in the same way that oil revenues have been wasted? Unlike petroleum revenue, migration-related money reaches poor families directly, and this simple fact might play a major role in sustaining their standard of living for some time, though it is hard to tell for how long. How can Ecuador cope with the transition, seizing this small opportunity, beset with major risks? How can Ecuador avoid the temptation for politicians to see migration and remittances as the relief valve for all of the nation's problems? How can Ecuador keep inertia from prevailing?

6.3 Leadership, institutions and identity

As in other Latin American countries, Ecuador's recent history has been a succession of opportunities and disappointments. The failure of populist approaches based on the oil boom and dreams of the seventies led to the lost decade of the eighties. The failure of neo-liberal approaches linked to the adjustment and liberalization processes of the nineties has given way to the crisis in which Ecuadorian society now finds itself. Both cases combine various mistakes in the very conception of economic and social policy, with the complex challenges that a country like Ecuador will face in order to break with the patterns of poverty-led growth – of growth that impoverishes. These problems are even more difficult to solve if we take into account the political and institutional breakdown that has characterized Ecuador's recent history. As a recent study puts it:

The last few years of different government administrations have fostered the conviction, in economic and social areas, that the State is no longer able to deal with the demands of all social sectors. This factor has led to a confused political climate in which defense of corporate rights is mixed with mere claims for the working conditions of the bureaucracy, inertia of the current political system and adjustment of certain societal stakeholders accommodating to new directions set by political and economic powers. (...) The State has ended up turning into an archipelago of superimposing jurisdictions, controlled by sectoral, labor-union, professional and civil-society entities¹⁹.

In the context of globalization, the political impasse that this has generated dramatically heightens the risks that Ecuador will fail to take advantage of existing opportunities and will, rather, lurch into another phase of poverty-led growth. This is because, under current conditions, cumulative historical inertia combines with the pressures from global markets to reinforce this perverse dynamic that lives off the poverty of its resources. Although opportunities remain to aspire to a different dynamic, if Ecuador is to take advantage of these it must make decisions that demand a kind of social and political agreement never before seen in the country. Over the last 20 years, the entire Ecuadorian political system has deteriorated, not only in terms of parties and government, but also in

¹⁸ Ecuador Economía: Boletín Económico Mensual [Monthly Economic Bulletin], January 2001, p. 3

¹⁹ FLACSO-UNICEF pp. 17-18

terms of regional, sector and grassroots leadership, which have also lost legitimacy. This breakdown of political leadership and accountability has intensified the problem of corruption, and the widespread perception that people seem to have of it.

However, this is not just a problem of leadership and political consensus-building. As we saw, one of the most serious constraints to meeting the challenges of globalisation and breaking out of the cycle of poverty-led growth, is found in the weakness of Ecuadorian institutions themselves. Even in those cases where agreements are actually reached and decisions made, there is a marked inability to turn those agreements and decisions into actual results.

In the private sector, we have imperfectly-operating, fragmented markets, and most economic and social life happens outside those markets. Businesses and investors, in turn, continue to act in their traditionally rent-seeking ways, with a strong slant toward exploiting resources and clinging to them as cash cows, rather than turning toward profitability grounded in genuine competitiveness. What will it take to develop Ecuador's markets, and create dynamic, modernizing entrepreneurial life?

As for the public sector, many institutions of national government, as well as regional and provincial authorities, have been unable to react to even the simplest challenges. What will it take to reconstruct national institutions and revitalize public management capacity? There are local and community institutions that, although still weak, want to take part in the provision of basic social services. Will this be an important option for moving forward in this direction?

Finally, there is the issue of identity: national identity, cultural identity, and citizens' identity. A longstanding sequence of hopes, crises and shattered dreams would seem to have generated an even more profound crumbling of Ecuadorian identity, as the recurrent debate about local or regional autonomy as well as the nature of many recent protests demonstrate. This is particularly dangerous in the context of globalization, since a sound national identity and a strongly integrated society provide the only real foundation from which to grasp the opportunities that are appearing and to overcome the inherent risks. How will Ecuador rebuild its sense of identity as a nation?

Attempts to promote social organization and participation must also work to build this shared identity. It is necessary to ask what type of institutions – and what type of public policies – best fit the building of an identity, and what type of economic, social and political process should be pursued. It is necessary to understand that the 'type of society' that we hope to create is seen very differently by different societal players. Promoting the construction of a common identity must not mean ignoring diversity or existing differences. On the contrary, recognizing and acknowledging different visions, diverse and even opposing interests, various social and cultural practices, is a necessary step in any process of building agreements and learning to 'live together'.

REFERENCES

CEPAL [ECLAC]: *Estudio Económico de América Latina y el Caribe: 1999-2000 [Economic Study on Latin America and the Caribbean: 1999-2000]*, CEPAL, Santiago

Instituto Nacional del Niño y la Familia [National Institute of Children and Families]: (1999) *Los niños y las niñas del Ecuador [Boy and Girl Children in Ecuador]*, Los Indicadores del SIICE [Indicators of the SIICE], No. 1, Quito

Vos, Rob (2000), *Ecuador 1999: Crisis económica y protección social [Ecuador 1999: Economic Crisis and Social Protection]*, Estudios e informes del SIISE [SIICE studies and reports], No. 1, Ediciones Abya-Yala, Quito

Larrea, Carlos (2000) *Pobreza, exclusión social y democracia en Ecuador [Poverty, Social Exclusion and Democracy in Ecuador]*, mimeographed

José Peralta Foundation (2000) *Ecuador: su realidad [Ecuador: Its Reality]*, Quito

FLACSO/UNICEF, *El nuevo modelo monetario y el sector social: balance inicial [The New Monetary Model and the Initial Social-sector Balance]*, preliminary version

Jácome, Luis; Larrea, Carlos; Vos, Rob (1998) “Políticas macroeconómicas, distribución y pobreza en el Ecuador” [“Macroeconomic Policies, Distribution and Poverty in Ecuador], in Ganuza, Enrique; Taylor, Lance; Morley, Samuel (eds.) *Política macroeconómica y pobreza en América Latina y el Caribe, [Macroeconomic Policy and Poverty in Latin America and the Caribbean]*, UNDP, Ediciones Mundi-Prensa, Spain

Corporación de Estudios para el Desarrollo [CORDES – Development Studies Corporation] (1999) *La ruta de la gobernabilidad [The Route Towards Governability]*, CORDES, Quito

UNDP, *Informe sobre desarrollo humano 1991-2000 [Human Development Report 1991-2000]*, UNDP, Ediciones Mundi-Prensa, Spain, several years

World Bank: (2000) *World Development Report 2000/2001: Attacking Poverty*, Oxford University Press

Economic Commission for Latin America and the Caribbean (CEPAL/ECLAC) (2000), *Panorama social de América Latina 1999-2000 [Social Panorama of Latin America 1999-2000]*, United Nations, Chile

León, Mauricio; Vos, Rob (2000) *La pobreza urbana en el Ecuador: 1988-1998: mitos y realidades [Urban Poverty in Ecuador: 1988-1998: Myths and Realities]*, Estudios e informes del SIISE [SIICE studies and reports], No. 2, Quito

CHAPTER 8: LIBERALISATION, POVERTY-LED GROWTH AND CHILD RIGHTS:
ECUADOR FROM 1980 TO 2000

UNICEF (1999) *Crisis social y económica y derechos de la niñez ecuatoriana* [*Social and Economic Crisis and Ecuadorian Children's Rights*]

World Bank *Ecuador: Poverty Report*, Report No. 14533-EC, W

Norbert Fiess, Dorte Verner (2001) *Intersectoral Dynamics and Economic Growth in Ecuador* World Bank, Washington D. C.

UNCTAD (2000) *The Competitiveness Challenge: Transnational Corporations and Industrial Restructuring in Developing Countries*, United Nations, New York