

Ecuador

Status Index (Democracy: 6.20 / Market economy: 5.11) 5.65		Management Index 3.66	
HDI	0.759	Population	12.9 mil
GDP per capita (\$, PPP)	3.641	Population growth¹	2.2 %
Unemployment rate	N/A	Women in Parliament	16.0 %
UN Education Index	0.86	Poverty²	17.7 %
		Gini Index	43.7 (1998)
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003. ² Population living below \$ 1 (1990-2003)			

A. Executive summary

The period under review by this report corresponds to the term in office of President Lucio Gutiérrez, who had governed since January 2003 and was deposed in April 2005 by parliament as a result of dubious proceedings. Gutiérrez was awarded political asylum in Brazil; his duties were assumed by Vice-President Alfredo Palacio. Ex-Colonel Gutiérrez, who first came to the political forefront in January 2000 through the Operetta Putsch against Jamil Mahuad's government, came to power through free and fair elections with a coalition of left-wing parties and movements. Initially, Gutiérrez's political rhetoric and the appointment of members of Pachakutik, the leading indigenous movement, to high government offices seemed to suggest that there would be political change and, in particular, an intensified fight against corruption. However, a significant change of political direction to establish more stable structures for democracy and a social market economy failed to come about. This was partly due to the low backing the president received from the legislature but also to the government itself and its limited political coherence, its clientelism, nepotism and corruption.

Following the break-up of the coalition with Pachakutik, the government formed alternating alliances with right-wing parties such as PSC. It found the closest cooperation and its strongest support, however, in the populist PRE Party. Through this cooperation, the PRE succeeded in the unconstitutional deposition of the judges of the Supreme Court, the Constitutional Court and the Election Court, which enabled the (temporary) return of the PRE leader and ex-President Abdalá from exile in Panama. In addition to this, Gutiérrez maintained close contacts with the populist PRIAN party of the entrepreneur Alvaro Noboa who was thus able to secure support for his private business interests.

The Gutiérrez government was marred by corruption scandals and contempt of constitutional norms, the above-mentioned intervention in the courts certainly being the most significant. In April 2005, the protests against Gutiérrez, which had continued since the previous December, finally culminated in social unrest, leading to the deposition of President Gutiérrez.

The Ecuadorian economy was strengthened through the rise in the price of oil, which represents the country's main source of income. Remittances from Ecuadorians living abroad were also significant and came to represent the second largest source of income. The dollarization process is on a course of stabilization, although economic big-players show uncertainty regarding the conditions of stability. Despite the improvement in macroeconomic indicators in recent years, the weak rule of law has made the country less safe for investments.

Alongside Bolivia and Peru, Ecuador is one of three Andean countries that have grown increasingly politically unstable over the past two years. As in Bolivia, a "people's putsch" (*golpe popular*) drove the governing president from office and out of the country. A strategic necessity in these countries is the (re-) securing of democratic institutions and the creation of new lines of political consensus. In terms of market economy development, Ecuador resembles Peru and Bolivia in that its potential is by all means favorable (e.g. oil). To this end, a more consistent regulatory policy must be implemented. This policy must be adapted to the country's development potential and emphasize social equality more so than thus far.

B. History and characteristics of transformation

Ecuador's transition from a military dictatorship to a democratic system of government took place in 1979. Ecuador was one of the countries gripped by the third large wave of democratization in Latin America in the late 1970s. The Ecuadorian process of transition took place upon the basis of an agreement between civil reformers and sectors within the military intent on more openness. Transition suffered because powerful conservative, liberal and other sectors of society were opposed to transition and were therefore excluded from influencing future policies.

The political alliances that subsequently formed civil governments also proved too weak to integrate the opponents of transition into the new political order. This group, which excluded itself from the process of democratization, nevertheless continued to be influential and even won the presidency five years after the transition process had begun. From this position they attempted to undermine one of the essential agreements of the transition, i.e. political participation through parties by anchoring political participation through so-called *Independientes* (independents) in the constitution.

The political elite generally lacked widespread appreciation for the democratization process and its rules of the game, which some political actors did not regard as their own. Transition therefore failed to reach a consensus on the mechanisms of the allocation and distribution of political power; this in turn restricted the consolidation, legitimacy and durability of the democratic model. Since transition, inconsistencies have developed between political participation and representation: while the parties held a monopoly over political participation, they failed to anchor themselves in society in a manner that would have enabled them to fulfill the function of representation. They therefore lost legitimacy rapidly.

The Ecuadorian process of democratization took place against the background of a long and profound economic crisis that further impoverished vast sectors of the population rather than alleviating poverty. The consequence was a delegitimization of the democratic model thus lost legitimacy as large sections of the population did not consider it capable of solving the most urgent economic problems. The economic crisis led to a considerable reduction in material resources, human and power resources, while the state increasingly lost control over these assets.

Furthermore, the economic crisis brought international financial organizations onto the national political scene in the form of political actors participating in political events in accordance with specific preconditions; there was practically no space for discussing or questioning their conditions or decisions. This by no means fortified the legitimization of the democratic model. Twenty five years after the formal transition to democracy, the population's illusions the population have given way to mistrust toward the democratic system.

The cycle of political crises in the past eight years began in February 1997, with the resignation of President Abdalá, who parliament and pressure groups forced out of office. Then National Congress President Fabián Alarcón succeeded him, albeit via marginally constitutional proceedings in which political actors ignored official procedure. Political stability seemed to have returned with the adoption of a new constitution and the assumption of office of President Jamil Mahuad in August 1998. After a few months, however, the government, and society as a whole, were shaken by a financial crisis that led to measures including the introduction of the U.S. dollar as the national currency and finally a *coup d'état* on February 21, 2000. In order to preserve the institutional continuity of democracy to some extent, the relevant political parties and actors agreed on the nomination of Vice-President Gustavo Noboa for the office of president; Noboa held office until Lucio Gutiérrez took over the presidency in January 2003.

As in most other South American countries, the transformation of Ecuador's market economy involved abandoning the traditional model of development that had been so typical in Latin America from the 1930s onwards. This model

consisted of industrialization as a substitute for imports. This meant that market-based structures did exist during the transition to democracy, but the domestic market was relatively isolated and over-regulated with a wide-reaching public sector. In Ecuador, this was partly a result of the early 1970s oil boom under military rule that was not channeled into a consistent and sustainable economic policy. Instead, the military's outdated development plans not only brought about increasing macroeconomic imbalance within Ecuador; they also resulted in growing budgetary deficits and an explosion in state and private debt.

The debt crisis of the early 1980s revealed the frailty of this development model. In the ten years that followed, the governments of Hurtado, Febres, Cordero and Borja made a great effort to stabilize the Ecuadorian economy with varying and altogether very little success. Measures taken in economic policy were, however, increasingly determined by IMF alignment requirements. Even under the somewhat chaotic governments of the 1990s, no fundamental stability was achieved.

In 1998-2000, these developments resulted in Ecuador's worst economic crisis of the 20th century. Although triggered by a combination of factors, the Ecuadorian economy was already crisis-prone by the mid 1990s. Poor decisions in economic policy making and various negative external influences e.g. *El Niño* floods in late 1997 that affected the agriculture of coastal regions in particular; the retreat of investors and creditors from Ecuador during the crises in Asia, Russia and Brazil in 1998/1999; a severe drop in oil prices on the international market in 1998, which led to a drop in export revenue) exacerbated the difficult situation.

The liberalization of the Ecuadorian financial market also led to a prolonged financial crisis that began in the mid 1990s. The dependency on the export of primary goods and on few price-volatile products in particular largely makes Ecuador more prone to external influences. Until late 1999, the Ecuadorian economy recorded a 7% reduction in GDP but was able to recover in the years that followed. However, even after this deep crisis, fundamental reforms of the market economy were not undertaken. President Mahuad's introduction of the dollar as the national currency in 2000 marked the only milestone. Although this step helped to lower inflation, it was also one of the reasons for Mahuad's removal.

C. Assessment

1. Democracy

Ecuadorian democracy has been on a roller coaster course for almost the past eight years. During this period, the Ecuador's key political actors failed to make it sufficiently clear that they accept democracy as a means of carrying out controlled conflicts and that they value the rule of law. During crisis situations, such as the removal of ex-President Bucaram or the *coup d'état* against President Mahuad, the laws of democracy were not observed. However, this has only recently begun to pose a threat to the system. In blatant terms, Ecuadorian democracy currently lacks the democrats needed for it to function.

1.1. Stateness

The Ecuadorian state is recognized by its citizens; its legitimate monopoly on the use of force is not questioned. Nevertheless, radical sectors can be found within the indigenous movement that dispute the state in its present form and play a significant role in cyclical form. As movements with an ethnic and/or regional base, their presence is felt more during economic crises or when processes of political reform are launched. The ethnic movement strives for state reform to inscribe the multicultural nature of the country into its institutions, whereas the regional-based movements press for greater autonomy for local government. Although the ethnic question and the conflict between the regions have been present since the founding of the republic and even represent the very crux of Ecuadorian politics, they do not question the existence of Ecuador as a state. Although the infrastructure and the public administration show deficiencies, the state and its institutions – particularly the armed forces and the police – are present throughout virtually the entire territory.

All citizens are equal in formal and legal terms; in practice, however, the indigenous and Afro-Ecuadorian populations in particular are victims to discrimination. Overall, Ecuadorian politics are separated from the church, although the Catholic hierarchy has a habit of interfering in domestic political issues. One immediate danger to the state's territorial control is the conflict in Colombia, which is weakening the stability of the country's northern border. This is a sensitive factor that could change at any moment. Although Ecuador has pursued a diplomatic policy of non-involvement in the "inner Colombian" conflict, the government increasingly bows in to the will of the United States – such as with the authorization of an air force base or with the silent agreement to the sinking of ships bearing the Ecuadorian flag that were suspected of drug or human trafficking.

1.2. Political participation

The population determines who rules and enjoys further political freedoms. There are no noteworthy restrictions to free and fair elections. The elected rulers principally dispose of effective governmental power, albeit not completely; there exist veto powers outside the governmental system (military, economic elites).

The freedom of assembly and of association is, to a great extent, unlimited, i.e. independent political and/or civil groups can form and assemble freely. It is possible to speak of an ethnic mobilization insofar as Ecuador's indigenous movement has gained significance as a political actor in recent years. This movement has managed to establish itself durably in the political landscape. Nonetheless, during the period under review, its role has diminished somewhat as a result of attrition in response to the movement's cooperation with the Gutiérrez government, and the movement's strategy of splitting as an organization. Although the government has tried to pressure the media by way of threats or administrative measures, there are no serious restrictions to freedom of thought or the press; citizens, organizations and the media can express their opinions freely.

1.3. Rule of law

The biggest retrograde step in the development of Ecuadorean democracy can be seen to have taken place in the last two years in the area of the rule of law. It must be conceded that the constitutionally enshrined separation of powers has traditionally been disregarded on a regular basis, and a structurally underpinned latent political conflict between the executive and the legislature has repeatedly led to situations of impasse. In its last two years, however, the Gutiérrez regime became infamous for its active assistance to lawbreakers in the evasion of justice by its protection of those intimates and relatives of the president accused of criminal offences and venality. Encroachments into the separation of powers also occurred, principally in the unconstitutional deposition of the judges of the Supreme Court, the Constitutional Court, and the Supreme Electoral Court at the end of 2004.

This anti-democratic conduct encouraged further breaches of constitutional norms that fell victim to the president's political cunning and the legislative majority. This behavior is in line with the 'political culture' of Ecuador's political elite, for whom controlling the courts is at best as a means of asserting immunity or blackmailing political opponents, such as members of the opposition or journalists. Often informal, this form of influence repeatedly undermines the independence of the justice system, notably in court cases against politicians.

Although differentiated, the judiciary's functions are restricted in part by corruption and political influence. Furthermore, a citizen's ethnic and socioeconomic status can determine the treatment they receive from the judiciary.

However, this does not lead to a general incapacitation of judicial control and inquiry. The population considers political and bureaucratic corruption to be high; combating this is generally seen as being one of the most urgent problems. Nevertheless, corruption is practiced throughout all levels of society. As a rule, corruption is prosecuted, although corrupt deputies continue to find political, legal and procedural loopholes. There are generally no serious restrictions to civil rights.

1.4. Stability of democratic institutions

Ecuador's democratic institutions do not always show stability in performing their functions and there is frequent inter-institutional friction. Majorities with the power to block in parliament and the government act as constraints on institutional efficiency. Within the logic of these blockades, there are cases in which political actors move along the outer margins of the constitution. Members of parliament's persistent attempts to reform the country's constitution and exploit its democratic institutions have negatively influenced the population's perception of democratic institutions. .

In terms of their acceptance, Ecuador's democratic institutions can by no means be regarded as stable; they do not possess the necessary degree of autonomous enforcement. On the contrary, they serve primarily the particular interests of political actors. At times, mass demonstrations articulating the public's interests will replace the function of democratic institutions. While the relevant political actors accept and support Ecuadorian democracy in general terms, they do so only conditionally, i.e. as long as their interests remain unthreatened.

1.5. Political and social integration

The political party system features a high degree of organizational instability and a relatively high degree of fragmentation (the effective amount of parties in parliament is currently 6.81). Since transition in 1979, it has been impossible to establish a stable, socially anchored political party system. The parties' low programmatic competence, their strong personality-driven and clientelist tendencies and their somewhat regionalist orientation all contribute to their relatively limited level of social anchoring on a national level and to their latent instability. Short-term and fragile political alliances were therefore the order of the day during all phases of government since political transition and remain characteristic of Ecuador's political landscape. Voter volatility continues to be relatively high.

Ecuador's landscape of interest groups is relatively non-differentiated with only some groups able to represent certain interests. These include first and foremost

trade associations. Trade unions, on the other hand, have lost much of their influence and are now of mere secondary importance. Significant social interests are thus under-represented, and the system of interest groups is dominated by relatively few actors. Only in recent years have broader social interests found representation and begun to penetrate the political system. Since the mid-1990s, segments of civil society that until then had been increasingly under-represented have anchored themselves as functional representation bodies within the political system. This includes, for instance, the indigenous representation body, but also the organized social movements.

According to data by Latinobarómetro, disappointment in the democratic system has greatly increased. In 2003, only 23 % of those surveyed stated that they were content with how democracy was performing. In 2004, this already low level of consent sank to 14 %. Although 46 % of Ecuador's citizens believe that democracy is preferable to any other form of government, problems increasingly arise as more and more citizens perceive democracy as the cause of the government's problems.

A further element that burdens Ecuador's political culture lies in the traditions of populism and left-wing radicalism, both of which share a Manichaean attitude of friend-or-foe. This leads to a lack of recognition for political opposition and to limited regard of plurality, both indispensable elements for the success of democratic consolidation.

2. Market economy

The deep economic crisis between 1998 and 2000 and the long financial crisis of the 1990s can still be felt today due to the senate's failure to regain the greatest part of the money it had spent on covering insolvent banks. Ecuador's dependency on primary export goods and particularly on a small number of price volatile products makes the country quite prone to external influences. The Ecuadorian economy recorded a 7 % fall in GNP in late 1999 but was able to recover in the years that followed. In the past two years the indicators have been showing a tendency toward stability; according to data from CEPAL, GDP grew by more than 6 % in 2004. Nevertheless, the political leadership did not make use of the positive economic trend that resulted from high oil prices and the scale of remittances by Ecuadorians living abroad. These transactions reached almost \$1.2 billion in 2004 and have become the second largest source of income after crude oil.

2.1. Level of socioeconomic development

Central indicators show a relatively low level of development. According to the HDI of the UNDP, the country's development status slightly improved from 0.731 (2001) to 0.735 (2002), but the country dropped from 97th to 100th place. Although one cannot speak of equality between men and women, Ecuador does distinctly well in the GDI compared to other countries (79th place). Considerable inadequacies remain with regard to equal rights in access to education. The distribution of income likewise demonstrates continuing economic inequality, although at 43.7 %, the national Gini coefficient is above the average Latin American ranking. However, 40.8 % of the population lives below the poverty line of \$2.00 per day (1990-2002). In the period under review, there were no serious measures taken toward redistribution of income or even toward lessening the disparity between the various segments of society.

Social exclusion through poverty, education, ethnic or gender-specific affiliation is evidently frequent and is to an extent structurally consolidated. While there is no systematic or formal pattern of exclusion as in other countries where women or other certain members of society are forbidden from working, there are clear social barriers in Ecuador that restrict equal participation and access to the market; these include prevalent racism.

2.2. Organization of the market and competition

The fundamentals of market-based competition are principally guaranteed. However, the market-based rules of the game are neither clear nor stable – a phenomenon that applies to the entire legal system. Some prices continue to be fixed by law, such as in economic sectors or in the case of products where monopolies or oligopolies exist, for example in the export of bananas and wheat flour. Both sectors are controlled by the same economic group, which has its own political party in parliament (PRIAN) to represent it and defend its interests. State interference in the private sector is therefore sporadic; the private sector succeeds through its own political representatives and agreements, uses the state to its own advantage, and thus incapacitates the principles of a market economy. The consolidation of the market economy is further hampered through the enlargement of the informal sector (around 45 % of the workforce).

Not all sectors of the economy boast complete competition, and in the most important sectors there are private or state monopolies (in particular the sectors of crude oil, energy and communication). Overall, the state plays no active role in the prevention or combating of monopolies.

A chief item on the government's agenda is the negotiation of the American Free Trade Agreement (Área de Libre Comercio de las Américas, ALCA),

demonstrating its interest in promoting international trade. However, the data on the balance of payments is not a very encouraging sign of stable development in foreign trade: in 2003, 28 % of GDP in goods and services was imported and 24.3 % exported. This indicates a drop in exports. A serious problem of a completely different nature is the high level of corruption within customs, which is a greater strain on trade exchange than the customs duties themselves. As a result, goods disappear or bribes or ransoms have to be paid.

The banking system and the capital market have a low level of differentiation and competitiveness and also lack adequate regulation. The problems of the banking system were therefore the most evident manifestation of the severe economic crisis of the late 1990s when the amount of bank insolvencies rose enormously. An attempt was made to rehabilitate the banks through the concession of additional loans to endangered private banks by the Ecuadorian central bank; following the first phase of this unsuccessful plan, the executive and legislature agreed in late 1998 on a universal deposit security guarantee and the founding of a deposit securing agency. In spite of these problems, the banking system has gradually improved its performance: in 2004, the banks made profits of \$200 million with an increase in deposits. Newly founded banks now have to fulfill higher equity capital standards.

2.3. Currency and price stability

The introduction of the U.S. dollar in 2000 put an end to the routine manipulation of monetary and exchange rate policy by Ecuadorian politicians. In January 2000, President Jamil Mahuad announced Ecuador's dollarization; within six months, the U.S. dollar became the country's only valid means of payment, replacing the sucre as the national currency on September 10, 2000. The Mahuad government saw this as the only way to prevent looming hyperinflation. The escalation of the financial and banking crisis into a general economic crisis was the central dimension of the process that had led to dollarization in Ecuador.

Dollarization nevertheless led to considerable price increases, which destabilized the domestic market and increased production costs, thus harming the competitiveness of Ecuador's economy. One positive aspect was that dollarization brought inflation under control, from 91 % in 2000 and 22.4 % in 2002 to 6.1 % in 2003 and 1.9 % in 2004. As far as the exchange rate is concerned, Ecuador is now bound to the course of the dollar. The international devaluation of the dollar in 2004 at a time of simultaneous low inflation led to an improvement in the country's exchange rate, which has now returned to the levels of 1992-1998, prior to the banking crisis.

In the midst of the government's political instability, President Gutiérrez did have the dexterity to entrust economic policy to technocrats committed to the measures

promoted by international financial organizations for macroeconomic stabilization and reduction of the deficit. Despite governmental chaos and the clientelist exploitation of public funds, the macroeconomic balance was preserved. During those two years, the country benefited from the support of the IDB, the IMF and the World Bank and even the United States, which increased cooperation with the Ecuadorian government thanks to the geopolitical significance of Ecuador for U.S. strategy in Latin America, particularly with regard to “Plan Colombia.”

2.4. Private property

Private sector enterprises represent the backbone of Ecuador’s economy although state-owned companies also exist. Ecuador is one of the countries in Latin America to have carried out the least privatization. There is strong state control in the areas of communication (except for part of the mobile telephone sector), electricity, crude oil and pension schemes. Property rights and property acquisition are sufficiently defined, although the weakness in the rule of law – inefficiency and non-transparency of the judicial system, corruption – causes problems in the effective enforcement of property rights.

2.5. Welfare regime

A state welfare and social policy is practically non-existent in Ecuador. Due to a lack of resources, successive governments have established short-term social programs but no social system. The social insurance system that exists for the narrow formal employment sector obliges employers to register their employees in the *Instituto Ecuatoriano de Seguridad Social* (IESS). Altogether, the state-run system in the field of health care, education and social welfare is insufficient. In 2004, the government channeled only 6.5 % of the budget into social spending despite the economic benefits provided by high oil prices, the devaluation of the dollar *vis-à-vis* the euro and the high rate of remittances. Only 16.3 % of all social security contributions were destined for investment, meaning the present inadequate structures can, at best, be administered but not improved or enlarged. The *Bono de Desarrollo Humano* is one of the most significant social policy programs benefiting over one million people. Since 1998, it has consisted of monthly allowances of between \$11.00 and \$15.00 given to people living in extreme poverty.

2.6. Economic performance

Ecuador’s economic performance is highly dependent on the crude oil sector – with a growing tendency in recent years. After 2.3 % growth in 2003, a rise in the production of (private) crude oil and high oil prices led to 6.3 % growth in 2004,

according to provisional estimates by CEPAL. The remaining economic sectors, however, are mostly stagnating, as is their contribution toward exports. Problems remain in the highly volatile investment quota, which continues to be oriented to the oil sector, and in the inadequate capacity to absorb the workforce. At 1.9 %, the low rate of inflation in 2004 roughly corresponded to the dollarization of the Ecuadorian economy.

The positive tendencies of the macroeconomic balance are of a more economic nature and are not the result of any explicit or stringent economic policy by the Gutiérrez government. The lack of clarity in economic policy makes it debatable whether the positive economic development will also withstand changes within the crude oil market. Indications for this low level of stability in economic development include the negative trade balance, the limited impact on the national employment market and the repeated rise in the proportion of the state budget made up by salaries, allowing for less flexibility in the structuring of the state budget. One positive signal is the recovery of the banking sector; faith in that sector has grown since the 1999 crisis. GNP per capita data reveals a process of recovery in Ecuador's economy with a rise from \$2,118 (2003) to \$2,325 (2004). This is even more apparent when compared to 2000 when GNP had fallen to \$1,296 following the great crisis.

2.7. Sustainability

Only occasional attention is devoted to ecologically compatible growth, a concept that is scarcely anchored in the country's institutions. Negative epiphenomena have been particularly immense in the Amazonian lowlands, where oil production has played a significant role in Ecuador's economic development since the 1970s. The Ecuadorian government's limited competence in shaping economic policy unavoidably led to a development model relying heavily on an oil industry whose production causes extensive ecological damage and whose expansion threatens to cause even greater harm to the Amazonian lowlands. Despite international pressure, the private oil companies as well as the state have been tentative in developing an ecological awareness that has led to the inclusion of environmental clauses oil in contracts. Support is given by environmental groups who actively warn of the ecological consequences of purely economic profit seeking. The state's limited power of intervention and its lack of ability or willingness to enforce the corresponding laws (such as that concerning primary forest use) remain a central problem.

With regard to education, vocational training, research and development, there exists dramatic disparity between private and public institutions. Private education institutions attract potentially qualified human resources, dispose of considerably greater material means and ultimately work more efficiently. As in the rest of Latin America, this education system contributes to an upholding of social

divisions and segmentation. Public investment in research and development is more or less nonexistent. Thus far, the private sector has not been able to close this modernization gap since its engagement is limited to isolated and dynamic areas of the economy and it does not have sufficient innovative power to be able to apply modern technology as a profitable investment. The spread of new technology is considerably underdeveloped: in 2002, only 3 % of the population owned a personal computer and internet use is also low throughout society (around half a million users in a population of almost 13 million).

3. Management

In August 1996, President Bucaram, known as “El Loco” (the Madman), came to power. Since then, political stability has not been achieved. During this period, there have been six presidents, including the current President Palacio. This has had an overall negative outcome on the effectiveness of the government’s dealings and on the stringency of public policy. Due to the high level of fragmentation of the parties in parliament and the practice of using blockade policy as a political means of negotiation, the past six presidents had great difficulty achieving a majority in parliament. Despite high expectations of political renewal that had been fueled during the election campaign, the government of President Gutiérrez continued the succession of poor governance in Ecuador. This was manifested in limited policy achievements, the president’s very weak political leadership – the president being important as an impulse generator and integration figure in a country of such ethnic and social heterogeneity – and his low level of competence in solving problems. Added to this, he and his team had little political experience. Gutiérrez was nevertheless smart enough to leave economic policy in the hands of experienced technocrats – partly due to pressure from industry and international financial institutions.

3.1. Level of difficulty

The degree of difficulty for the continuation of democratic and market-based transformation in Ecuador is estimated to be medium to high due to relatively (but not extremely) low economic and social development levels, social and ethnic disputes, and the state administration’s inefficiency. The diversity of social actors renders political decision-making processes extremely complex. The diversity of political parties and movements is attributed to dissimilarity in political identities in the country. This makes it difficult to achieve the parliamentary majority necessary to pass laws. Added to this, consensus is hampered through an unyielding political culture of minimum cooperation between the political actors who move within the logic of a zero-sum game.

Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	4
System of government:	<i>Presidential</i>	Electoral system disproportionality:	27.24
		Latest parliamentary election:	20.10.2002
		Effective number of parties:	7.7
1. Head of State	<i>Lucio Gutiérrez</i>	Cabinet duration:	01/03- 04/05
Head of Government:	<i>Lucio Gutiérrez</i>	Parties in government:	2
Type of government:	<i>divided government</i>		
2. Head of State:	<i>Alfredo Palacio</i>	Cabinet duration:	04/05- present
Head of Government:	<i>Alfredo Palacio</i>		
Type of government:	<i>divided government</i>		
		Number of ministries:	15
		Number of ministers:	15
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. For presidential/ semi-presidential systems, the geometric mean of presidential election and parliamentary election disproportionality is calculated. Effective number of parties reflects the political weight of parties (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i. Number of ministries/ ministers denotes the situation on 1 January 2005.</p>			

Ecuador has a lively and broad culture of organizations, which constitutes a strong civil society. Stark cooperative and clientelist traits do not always facilitate governance. These tendencies furthermore hamper the development of a civic culture. A positive development with regard to civil and cleavage-related structural problems is the *indígena* movement. *Indígena* integrated itself step by step into the democratic system and its institutions rather than remaining a marginal anti-system group.

3.2. Steering capability

The Gutiérrez government's capacity to act with a long-term plan or in the interests of the country was only marginal. Its activity was marked by ad hoc measures, haphazardness and short-term political utility maximization without appearing to set priorities. This low level of control was partly caused by leadership problems, the governmental team's lack of experience and the absence of a political and economic program. Following the exclusion of the Pachakutik team, which played such a decisive role in the creation of programs, the government did not succeed in redefining its political goals. This led to the government repeatedly changing the guidelines of its policies without being able to contemplate more long-term perspectives. Thus the government made two attempts to implement reforms in the oil sector and three attempts to do so in the electricity sector. The political instability that the country is experiencing causes

the government to concentrate chiefly on keeping the president in office and preventing him from being deposed through legal or illegal methods.

Economic policy was the only area in which fairly midterm policies were maintained due to the government's effort to conform to the ideas and demands of international financial institutions. However, the economists' "vision" concentrated on macroeconomic stability rather than on striving for institutional consolidation and reinforcement of the market economy. In late 2004, the government nominated executive members of the central bank whose credentials were more political than fiscal; this can be regarded as inconsistent with the aforementioned goals and thus as a weakening of the market economy. As a result, some policies had a counterproductive effect on other fields of policy. The minimal regard for constitutional procedures had direct consequences for the consolidation of the market economy with an atmosphere of legal uncertainty that began to spread. The leading political actors reacted to errors and policy failures by making changes, but these were so marginal that their policies remained trapped in a rut of routines.

3.3. Resource efficiency

The utilization of available resources by the Gutiérrez government was only partially efficient. One part of material resources was used by the government for clientelist purposes in order to satiate its supporters. Gifts were distributed among the population (foodstuffs, tools, etc.) in a classical populist patrimonial fashion while public money was used to secure the support of parties or deputies. The state's administration of funds is altogether inefficient and does not allow for long-term planning; large sums of money disappear due to corruption. Efficient appraisal is inexistent; the same can be said for transparent planning and transparent execution of the national budget.

Deficits are evident in the field of human resources. A large share of trained administration employees was dismissed as a result of reform measures. The administration is not clearly structured and its configuration does not enable effective management in line with professional rationality criteria. Administrative posts of strategic importance continued to be filled by the government solely according to political party criteria. This is due in part to the fact that the government party *Sociedad Patriótica 21 de Enero* lacks professional personnel for the state administration and also to the patrimonial concept of exercising state power. Even President himself brought friends and relatives into key positions; protests against these appointments were only voiced in the international domain. As a representative of Ecuador, Gutiérrez wanted to nominate a man with no knowledge of English for the Inter-American Development Bank (BID/IADB) and other international organizations based in the United States. It was only after other member states expressed their irritation that his attempt to nominate his

unqualified brother-in-law to the post of judge at the *Tribunal Andino de Justicia* failed. The use of personnel funds was altogether non-transparent. A large proportion of budgetary funds flowed into salaries while only 16.3 % of the social budget went toward investment.

Corruption is a feature of Ecuador's state and administrative culture with state resources being distributed on the basis of clientelist networks. The Gutiérrez government came to power promising to combat corruption, but it was not only unable to construct integrity mechanisms: the government even kept with the Ecuadorian "tradition" of protecting the interests of their own functionaries and those of their political allies who were involved in corruption-related court cases. Transparency International's corruption index ranks Ecuador 112th among 145 countries.

3.4. Consensus-building

Ecuador's political elites seem to agree on the two objectives of market economy and democracy. However, this is more of a "business as usual" phenomenon intent on exploiting democratic institutions and accepting market-based regulation for profit motives – whatever the terms. The political elite show no visible degree of support or respect for democracy and the (social) market economy as long-term objectives. Undertakings that are barely constitutional, and others that are even unconstitutional, are accepted as solutions to crisis situations and to political conflicts rather than efforts to internalize the goal of upholding of the constitution. It should be noted that a major proportion of business takes place under semi-legal circumstances where profitability would be marred through more stringent reforms. This is partly intensified through the substantial interests of certain national entrepreneurs who are used to being protected by the state and would not be able to survive under open market conditions. Furthermore, political differences exist on the degree of regulation in the market economy. The actors do not agree with classical liberal democracy; some refer to "participative" democracy that places chief emphasis on the social aspect.

The executive was still not able to control all veto actors, but it was at least capable of limiting the use of blockade power. The military still counts as one of the most significant veto actors in Ecuadorian society; it also disposes of its own business companies, thus of its own resources. However, the opposition parties in parliament also de facto have the power to block reform processes. The balance of power corresponds more to the power games behind the scenes than to the logic, and thus the judgment, of responsible majorities.

The government was able to prevent an escalation of structural conflicts but could not reduce existing disparities. Ecuador's latent and sometimes open conflict camps are primarily of a regional and ethnic nature, but they nonetheless overlap

with social conflict camps. With regard to the consensus-oriented conflict management of the government in power, Ecuador's political elite can be said to lack understanding for this dimension of political management. The elite are far more directed by the political power struggles behind the scenes, which included the Gutiérrez government's primary concern with its own survival. The president's ability to achieve consensus was not due to a programmatic position, but rather through the distribution of public funds. He leaned on a group of seventeen deputies who resigned from their parties and acted rather like mercenaries for the government.

Since his arrival in office, President Gutiérrez has been confronted with instable majorities in parliament that are an expression of Ecuador's structural conflict camps. His term in office began with the *indígena* Pachakutik party, but this cooperation failed after only one year. There followed an alliance with the PSC, whose strongest man – former President León Febres Cordero, who counts as one of the puppet masters of Ecuadorian politics – represents more than just the coastal region Guayaquil, and thus embodies the regional conflict. The PSC passed a reform law concerning state civil servants, but cooperation ended after a dispute between León Febres Cordero and Renán Borbúa, the former deputy and cousin of the head of state. In 2004, these disputes led to impeachment proceedings against President Gutiérrez, whose survival was secured through the ad hoc formation of new alliances in parliament. In December 2004, this new parliamentary majority opted to unconstitutionally oust the judges of the Supreme Court, the Constitutional Court and the Supreme Election Court. All of these judges were considered to be close to the PSC. The elites' "political culture" thus continued under the Gutiérrez government, whereby particularistic and regionalist interests prevent the establishment of social consensus.

These political power games in Ecuador have priority over social goodwill and the participation of civil society, although both would prove strong resources for political management. These potential resources are implicitly damaged by a tendency toward political confrontation. In January 2005, the mayor organized protest marches in Guayaquil and Quito against the unconstitutional deposal of the judges by the legislature (and evidently by the executive). At the same time, the government used state funds in clientelist style to organize a counter-demonstration. Both cases demonstrate that Ecuador's political culture make it possible to divert the population's solidarity and civil society's participation into channels that increase confrontation rather than finding ways of alleviating the country's real divisions.

There have been no large-scale conflicts in Ecuador that would necessitate reconciliation between different sectors of society such as massive violations of human rights by military governments or civil war. Ecuador's political elite nonetheless recognizes the need to review historical injustices, particularly those against the indigenous rural population, but an explicit process of reconciliation

has not been initiated. Due to the manipulative nature of public opinion, this does present a potential source of conflict that is not given enough consideration by Ecuador's political elite.

3.5. International cooperation

The political actors work together with international donors, although they generally do not use international support in order to improve their policies. As in most small countries, Ecuador's political elite shows great interest in becoming a member of most international organizations, not least in order to compensate for its relative weakness in the international system and achieve greater presence. The only caution regarding this comes from sectors of the political left and of the indigenous movement; they suspect these organizations of concealing too much direct influence by the United States (such as with the American Free Trade Agreement).

The Ecuadorian government has proven very cooperative toward international organizations, in particular toward international financial institutions. The goal of this cooperation strategy was greater political support from multilateral organizations and governments with interests in the country, particularly the United States. One of the government's topmost priorities was the negotiation of free trade agreements, particularly that of the American Free Trade Agreement, for which the government relied particularly on the support of the United States. This had implications for the alignment of the reform agenda, particularly with regard to economic issues, but Gutiérrez' domestic political weakness prevented the implementation of mandatory reforms.

On the other hand, the use of social policy for clientelist purposes made him a very unreliable counterpart for international financial organizations. Following the expiry of an agreement with the IMF, Ecuador did not sign a new agreement because it was not able to implement the reforms demanded by the IMF, mostly for political reasons. The government condoned the eradication of coca on the northern border, which can cause serious damage to the health of the population and to the environment. A serious international problem is present just over the border with Colombia and there is a risk that the conflict could become internationalized.

The government initially attempted to present itself as a calculable partner, but it was not able to prove its credibility within the international community. Gutiérrez did not show much tact in handling bilateral and multilateral issues such as when he provided diplomatic vehicles for an Argentinean military rebel who was under house arrest. Gutiérrez forfeited his international image step by step due to his frequent changes of position and his somewhat unprofessional diplomacy – as in the case of the *Tribunal Andino de Justicia*. The necessity of political support

from Washington persuaded Gutiérrez to postpone the signing of the contract for the International Criminal Court (ICC) in order to grant immunity to U.S. troops stationed in Ecuador. In this instance, the government broke with the country's tradition of supporting U.N. policies.

4. Trend of development

4.1. Democratic development

Rather than becoming more robust, the degree of consolidation in Ecuador's democracy has weakened. This period of weakness has lasted for several years – beginning with President Budaram's period in office in 1996 and with his deposal by parliament in 1997, continuing under President Mahuad during the economic and political crisis and the coup against him in January 2000, until the achievement of relative stability under the Noboa interim government. During Gutiérrez' period in office beginning in January 2003, there were no fundamental changes in stateness and political participation opportunities. With the support of alternating coalitions, the president nonetheless repeatedly violated the constitution and the separation of powers, culminating in intervention in the Supreme Court and the Election and Constitutional Courts. This had a very negative effect on the stability of democratic institutions. The political power struggles and the strongly clientelist and patrimonial brand of politics weakened not only the Ecuadorian party political system in its function as a mediator between society and state, but it also weakened civil society. Approval of democracy as a form of government remains below 50 %, putting it below the Latin American average.

4.2. Market economy development

Over the past two years, Ecuador has made no great progress toward a solid market economy that accommodates social equality. The political weakness of the Gutiérrez government was evident in its failure to reform the economic sectors that required radical structural changes. A lack of resources prevented the government from applying programs to improve the infrastructure and services that are fundamental for the development of productive activities. The difficulties in implementing structural change of any kind are exemplified by the fact that Ecuador is one of the few Latin American countries not to have privatized any of its public companies. The reason for this was opposition from social and political sectors that blocked the attempts of various governments.

Although the economic situation underwent positive development during the period under review, this was not utilized to further develop the market economy. It is possible that managerial mistakes made by the government were partly

responsible for deterring investors. The climate of political instability hardly offers investors an attractive setting, and this was worsened by the rise in costs for labor and capital goods that resulted from dollarization. This weakened Ecuador in the rivalry to attract investors that increasingly exists between Latin American countries. Macroeconomic indicators show an upward trend, particularly with regard to growth and GDP per capita. However, other data, such as the erratic development of imports and exports, points toward markets being far from stabilized.

The weakening of lawful institutions and guarantees during the period under review substantially impaired the market economy's potential development. Investments and economic transactions require a framework of certainty and confidence, which can only be created through respect for the constitution. The accomplishments of democratic development show that this is not the case in Ecuador. Indeed, some state institutions became instruments for economic groups that were close to the government or were used to torment political opponents as in the case of the state tax authority (*Servicio de Rentas Internas*) or the Telecommunications Supervisory Authority (*Superintendencia de Telecomunicaciones*). The significant interplay between politics and the economy in Ecuador allows for little hope of positive perspectives.

Table: Development of macroeconomic fundamentals (2000-2004)

	2000	2001	2002	2003	2004
Growth of GDP in %	0,9	5,5	3,8	2,3	6,3
Export growth in %	4,23	-8,67	-1,53	1,48	2,92
Import growth in %	5,25	2,16	0,94	-2,43	1,94
Inflation in % (CPI)	91,0	22,4	9,4	6,1	1,9
Investment in % of GDP	20.5	21.9	24.8	23.8	23.1
Tax Revenue in % of GDP	n.d.	n.d.	11.1	n.d.	n.d.
Unemployment in %	14,1	10,4	8,6	9,8	11,0
Budget deficit in % of GDP	-0,1	-3,2	0,6	-1,2	-0,5
Current account balance (% of GDP)	5,8	-3,2	-5,6	-1,7	0,4

Source: CEPAL (www.cepal.org); ILDIS (2005): *Economía Ecuatoriana en Cifras*, ILDIS, Quito (www.ildis.org.ec); Servicio de Rentas Internas. .

D. Strategic perspective

With the deposal of President Gutiérrez, the acute political situation was initially diffused. The taking over of the presidency by Vice President Palacio nonetheless did not lead to a fundamental improvement in the country's political climate. Furthermore, Palacio, who did not have a majority in parliament, has not been able to assert the intended political reforms. Thus, in July 2005, he failed in his initiative for a legal referendum, which was to determine some fundamental reforms of political institutions (bicameral parliament, appointment of the Supreme Court). It is questionable whether Palacio can assert these projects given

the divided political landscape or even whether he will survive his term in office, which ends early 2007.

An urgent task in Ecuador thus remains the consolidation of democratic institutions and the lowering of the level of confrontation between the various political sectors. Only when this has been achieved can further measures be taken toward sustained development in the country and its society.

This makes it necessary to promote agreements between the relevant political actors who have until now demonstrated their skills as veto actors. One possible agenda could be the strengthening of an independent justice system by way of a coherent reform program. On the other hand, mechanisms have to be elicited that increase governability within the relationship between the executive and the legislature and facilitate the building of majorities in the legislature. The executive's policies come at great costs, which have negative consequences on the consolidation of democracy.

Regarding external support agendas of this kind, it is the United States that is most likely to assert influence on political actors. It would therefore not be in the U.S.'s interest if further political crises led to the destabilization of the Ecuadorian government as a negotiating partner or even of the whole state. Then again, it is questionable whether the United States has an interest in a strong Ecuadorian president able to withstand pressure from the United States, particularly on the issue of Colombia.

Although dollarization has contributed to the stabilization of the country's economy, it remains necessary to keep a close watch on its effects in order to prevent possible negative consequences in due time – such as those indicated in the negative balance of payments, the increase in export costs and price disadvantages compared to other countries. This would nonetheless have to be encompassed by a new productivity model to enable the country to offer more than mere cheap labor and tax advantages for investors – and to make the economy less dependent on external cash flow.