

Issues in State Modernization in Ecuador (EC-P1063)

I. Introduction

Ecuador's current political economy is largely a product of the boom that took place in the country's oil sector in the early 1970's. The pressure of heightened revenue flows created an "oil-exporting factional democracy," and a dichotomy between policies focused on minimizing the pitfalls of natural resource rents (widespread corruption, Dutch disease, etc.) and individual actors driven to maximize their profits.¹ Today, these pressures continue to mount for the country and in the face of significant positive growth indicators – in 2004, Ecuador's real GDP grew by 7.4% – it is increasingly apparent that if Ecuador does not take steps to address persistent governance and policy problems with the State, the stakes for a future failure will only increase.²

Before exploring the challenges facing a modernization of the state strategy for Ecuador, it is important to understand the unique characteristics of the State itself. Specifically, there are four characteristics that have shaped the current condition of the Ecuadorian state. First, Ecuadorian society is highly fragmented. Political and economic power is largely concentrated among the country's elite class and powerful military factions, and a smaller but still significant degree is located among organized labor groups, middle class professionals/businessmen/bureaucrats, and the indigenous movement. This has made consensus for policy reform difficult, as the State's structure and fluidity of operations have tended to take on much of the fractious nature of Ecuadorian society.

The second defining factor for Ecuador's state structure has been the entrenched conflict created by persistently disproportionate income distributions, the absence of a social consensus, a State agenda greatly defined by private interests, significant indicators of social exclusion, and almost constant dissension between the Coast and the Sierra regions. All of these factors have hindered the development of a healthy State structure. These variables have made the reward for actions designed to generate individual over communal gains abnormally high.

The third variable that both differentiates the Ecuadorian State and escalates the intensity of the challenges it faces is the fact that since the 1970's, the government has served as the primary administrator and distributor of oil rents. This role has stretched the resources of the State. It has become a producer of subsidized goods and services, a rescuer of private firms in distress, a provisioner of credit to the private sector, and a significant driver of employment and infrastructure activities for the country. This role has meant that the State's responsibilities have

¹ Inter-American Development Bank/World Bank, "Creating Fiscal Space for Poverty Reduction in Ecuador," 1-243: 9.

² Latin Source Macroeconomic Database for Ecuador, Annual Statistics as of November 13, 2006

grown while it has simultaneously taken on activities for which it may not be the most logical, experience, or cost effective leader.

A final key factor responsible for the current state of Ecuador's political economy is the weak governance and fragile institutions that have plagued the country, and created tremendous asymmetry between the Executive and Legislative branches, encouraged a high level of fragmentation in the political system and decreased popular participation in the political system. This variable has, as well as the three previously mentioned, also made the system process of public sector reform a tremendous challenge for Ecuador, from early stages of policy design to implementation. And other variables have only reinforced these problems, from the frequent turnover of public cargos to the persistently low technical capabilities in the Legislative branch.

II. Key Challenges for Ecuador's Modernization of the State

A. Public Sector Management

Public sector management is shaped by the processes and in those institutional spaces where the State designs and implements policies, delivers goods and services, and builds regulations to give process to its functions. For Ecuador, poor public sector management has not only hindered attempts to improve the State's operations but on a broader scale, prevented the country from achieving its full economic growth potential, investing in education and health programs to stimulate greater global competitiveness, and establishing itself as a country that is both representative and responsive to the needs of its citizens. For Ecuador in particular, as explained further below, the health of its public sector has been restricted by significant information asymmetries, a weak civil service, and a persistently rigid budget process.

a. Asymmetrical information

Part of ensuring that a country has a healthy public sector with actors with well-aligned motives depends on the quality of information that is made available to the general public concerning the sector's operations. The level of transparency offered with budget processes and the amount of clear communication provided concerning actors' participation in sectoral affairs are essential components of a healthy information system. As well, the quantity and quality of this information has been shown to have a positive correlation with citizens' perceptions about the legality, professionalism, and efficiency present in the sector.

In Ecuador, asymmetrical information problems have traditionally plagued the country's public sector, reinforcing the weak accountability, oversight and minimal participation by the majority that already existed. One index of budgetary transparency prepared in 2003 assigned Ecuador 31 points out of 100 in terms of the amount of transparency that exists in the country's public sector

operations. Specifically regarding budget processes, Ecuador scored lower than all of the other countries analyzed in the study, including its neighbors Colombia and Peru.³

As a result of these asymmetrical information problems, Ecuador's public sector also suffers from the absence of a real administrative career track.⁴ There is no clear mechanism in place to ensure that personnel decisions from recruitment to promotion are based upon objective criteria. Sizable clientalism persists, with decisions often made by individual actors or political parties. As well, it is unusual for employment vacancies in the public sector to be published, and promotions principally occur as a result of political affiliations rather than on the basis of individual merit or ability.

What all of this means is that asymmetrical information problems, and the corresponding absence of efficiency and transparency in expenditure management in the public sector have allowed individual actors to pursue policies that offer short-term, individual gains at the expense of creating more allocative inefficiencies for the overall system. Specifically, reports suggest that the aforementioned prevalence of private sector interests during policy design, high transaction costs of policy changes, the absence of long-term political horizons, and the persistence of weak enforcement mechanisms have contributed to Ecuador's inefficient public policies.⁵ So far, most attempts to remedy these problems have failed to produce the level of impact desired. Most attempted policies, for instance, have been delayed by the limited availability of knowledge and information technologies for identifying and isolating the causes of corruption, as well as the frequent churn of leaders in the public sector.

b. Weak civil service

One of the greatest common denominators found in successful public bureaucracies is a competent, professional civil service that operates on the basis of merit and is capable of both managing public policies and serving as the institutional memory for the country. In terms of development, an independent and professional civil service has been shown to facilitate the effective implementation of government policies and provide continuity during periods of government crisis and times of transition. For Ecuador, however, the creation of such a body has proven illusive. According to a study conducted by the Inter-American Development Bank in 2002 and updated in 2005, out of twenty-one countries in the region, Ecuador's civil service places sixth from the bottom in terms of measures such as efficiency, structural consistency and merit-based operations.⁶ These conditions have not only slowed policy implementation and stability, but also disincentivized improvements in public sector management.

³ Technical Note (TN), "Gestion Publica", 1-36: 27. The index referenced was prepared by the International Budget Organization in 2003.

⁴ Technical Note (TN), "Gestion Publica", 1-36: 7.

⁵ V Acosta, et al., "Veto Players, Fickle Institutions and Low-Quality Policies: The Policymaking Process in Ecuador (1979-2005)," 1-76: 13.

⁶ Technical Note (TN), "Gestion Publica", 1-36: 3.

The primary problem with Ecuador's civil service is that it is fragmented and plagued by a low level of professionalization. This issue is of paramount importance for Ecuador in particular due to the sector's history of frequent personnel rotations driven by mercurial domestic political influences. By one estimation, approximately 50% of upper level managers and directors in the sector change with the exit of a Minister or the President.⁷ Thus, while a proficient civil service is important for all countries, in a country such as Ecuador that already ranks low in terms of policy stability, and faces numerous institutional constraints to long term policy development, the importance is compounded by a substantially higher multiple. For example, between 1979 and 1998, when economic cabinet ministers in the country lasted on average less than one year in office. During these years, the government negotiated nine letters of intent with the International Monetary Fund and signed seven loan agreements, but they only fulfilled three of the agreements in the end. Thus, the "chronic volatility in the government [has] affected the "investment-like" or intertemporal continuity of policies in Ecuador, and the lack of policy continuity has affected the country's commitment to long-term economic reform."⁸

A second area that warrants civil service reform is the poor condition of human resource management in Ecuador's public sector. Deficiencies in the system have caused poor clarity about the size or demographics of the sector's workforce and a proliferation of non-performance based wage allowances have alarmingly increased salary expenses, thereby reinforcing the sector's already strong need for salary unification.⁹ As well, there is no government agency tracking the number of public employees in each department or the position that each individual holds. There is also no department that monitors employees who have been terminated in the public sector (and who have received indemnities), in order to ensure that they do not return to government employment through some other avenue.¹⁰ And while the statistics that exist suggest that the size of Ecuador's civil service may actually be below the regional average (2.7% of the overall population, in a region with an average of 4.3%), the salary and pension demands of the sector are disproportionately high, representing 7% of the country's GDP and more than 30% of its public budget.¹¹

It is quite complicated to measure the real value of public employees' compensation packages because not only do most departments have their own salary schedules, but today's base salaries typically represent barely a fraction of an employees' total compensation.¹² It is not uncommon for an employee's salary to include between 20 and 30 different items, from residence and transportation allowances to more dubious sounding expenditures such as a "responsibility bonus" and a "World Health Day bonus."¹³ Thus far, government attempts to unify all salaries under one matrix have fallen short. The Organic Law of the Civil Service and Administrative

⁷ Technical Note (TN), "Gestion Publica", 1-36: 8.

⁸ V Acosta, et al., "Veto Players, Fickle Institutions and Low-Quality Policies: The Policymaking Process in Ecuador (1979-2005)," 1-76: 11.

⁹ Ecuador: An Economic and Social Agenda in the New Millennium, 463.

¹⁰ World Bank, "Ecuador: An Economic and Social Agenda in the New Millennium," 463.

¹¹ Technical Note (TN), "Gestion Publica", 1-36 : 5-6.

¹² World Bank, "Ecuador: An Economic and Social Agenda in the New Millennium," 460.

¹³ World Bank, "Ecuador: An Economic and Social Agenda in the New Millennium," 474.

Career, Homologation and Unification of the Salaries of the Public Sector,¹⁴ passed by the government in 2003, was one such attempt to unify the majority of public employees' salaries throughout the country. Implementation of this law, however, has been slow to date and as of now, tangible improvements have proven somewhat elusive.¹⁵

These weaknesses, a product of frequent turnover as much as poor human resource management, have prevented the creation of solid incentives for increased work productivity and improved performance at the level of individual civil service employees. Evidence suggests that “the lack of a merit-based civil service has disrupted policy implementation, especially in areas like economic reform, education and social security.”¹⁶ As well, on this topic a positive correlation seems to exist between the degree of meritocracy present in public institutions and the level of corruption in the sector.

c. Rigidity of the public sector budget process

A third component of Ecuador's poor private sector management is the rigidity of the sector's budget process. According to a Public Expenditure Review, 83% of the central government's budget is devoted to pre-assigned funds.¹⁷ With an additional 13% of the government's budget also, in practice, pre-assigned, reports suggest that in recent years, the central government has had decision-making power over, on average, only 5% of the national budget.¹⁸ The implications of this rigidity are substantial. With limited room for flexibility with funding amounts and destinations, the state of the public sector budget process has inhibited the government's ability to use capital spending adjustments as a tool to respond to unanticipated financial needs and address any fallout from limited investment growth. Such rigidity has also reinforced the fact that 50% of pre-assigned funds are, according to one report, awarded to non-priority programs identified in earlier rounds of sectorally driven politicized budgetary proceedings.¹⁹

With such a system, it should not come as a surprise that Ecuador's fiscal situation has been plagued by fragility, with little room for maneuverability to respond to external actors and events, and little assurance that policy choices will be adopted based upon their ability to achieve optimal social outcomes. In the past two decades alone, Ecuador's macroeconomic performance has been affected by a variety of exogenous shocks, including a high dependency on the international price of oil exports, the debt crisis of the 1980's, the international financial and banking crisis in the mid-late 1990's, and the presence of natural disasters such as floods,

¹⁴ Officially titled the “Ley Orgánica del Servicio Civil y Carrera Administrativa, Homologación y Unificación de las Remuneraciones del Sector Público”

¹⁵ Technical Note (TN), “Gestión Pública”, 1-36: 5.

¹⁶ Acosta, et al., “Veto Players, Fickle Institutions and Low-Quality Policies: The Policymaking Process in Ecuador (1979-2005),” 1-76: 12.

¹⁷ Technical Note (TN), “Gestión Pública”, 1-36 : 22-23.

¹⁸ Technical Note (TN), “Gestión Pública”, 1-36 : 23.

¹⁹ Technical Note (TN), “Gestión Pública”, 1-36 : 23.

earthquakes and armed conflicts with neighboring countries.²⁰ Timely policy responses to these events, however, have been scarce. In 1987, for example, it took the government six months to resume oil production after an earthquake damaged the oil pipeline. The absence of significant funds for discretionary spending has also prevented Ecuador from adopting counter-cyclical economic policies. Since 2000, for example, the government's attempts to adopt and implement the necessary legislation to make efficient use of high oil prices have failed.²¹

B. Judicial Reform

In Ecuador, the ongoing instability in the political sector, the inherent complexity of the legal process, and the aforementioned poorly modernized state of the country's public sector management has generated a significant lack of confidence in the system. The general citizenry views little value in the rule of law as a fundamental element of governance in Ecuador. According to one survey, only 29.2% of Ecuadorians have confidence in the country's judicial system, compared to a regional average of 45.79%.²² And, while the system suffers from extreme volatility at the legislative level, the problem is equally apparent at the level of application, where the implementation of a law can become as much a pawn of political power brokering as the result of justice prevailing.

a. Lack of confidence in the rule of law

The lack of confidence in the rule of law among the general population in Ecuador is quite significant. Evidence suggests that only 15% of Ecuadorians believe that government actors obey the law.²³ The absence of such legitimacy has severely hampered the judicial sector's ability to serve as a regulator of corruption. More than 75% of Ecuadorians surveyed for one report agreed that laws are not fairly administered between poor and rich citizens, that the judicial system is not fair, and that judicial power is highly susceptible to economic pressures in Ecuador.²⁴ People with such opinions most likely do not assign great value to the obeisance of laws and regulations.

b. Barriers to access

A second factor driving Ecuador's need for judicial reforms are the persistent limitations on access to the country's judicial system. Traditional economic, geographic and cultural barriers have persisted over time without substantial improvement. Generally, the poorest communities and residents of marginally urban zones or rural areas have disproportionately borne the brunt of

²⁰ Acosta, et al., "Veto Players, Fickle Institutions and Low-Quality Policies: The Policymaking Process in Ecuador (1979-2005)," 1-76: 11.

²¹ Acosta, et al., "Veto Players, Fickle Institutions and Low-Quality Policies: The Policymaking Process in Ecuador (1979-2005)," 1-76: 11.

²² Technical Note (TN), "Estado de Derecho", 1-43: 25.

²³ Technical Note (TN), "Estado de Derecho", 1-43: 1.

²⁴ Technical Note (TN), "Estado de Derecho", 1-43: 29.

such impediments. High levels of distrust, delayed service deliveries, the absence of public policies for the development of judicial proceedings, and the actual costs associated with the sector have further promulgated the problem.

Evidence suggests that Ecuador's judicial inaccessibility is primarily the product of two factors. First, the geographical concentration of the country's courts in urban centers has severely constrained access to the system for some of the populations that most need legal services. 598 of the 681 courts are in urban areas.²⁵ And, although the country's thirty-two public defenders are dispersed throughout the country, there is no framework for overseeing their operations or for orchestrating the movement of decisions from the regions to the national arena if further examination is warranted.²⁶

The second causal factor is the high costs traditionally associated with legal proceedings. The health of Ecuador's judicial system has been severely impacted by the limited availability of free or low-cost legal services. In 1998, 139,354 civil cases were filed in Ecuador's courts. In 2001, the number of cases stood at 92,427. Most likely, this drop in cases was not due to decreased motivations for cases to be filed but rather, the result of the high judicial fees. The current system of judicial fees, established by the National Council on the Judiciary (CNJ) in the late nineties, has made legal proceedings unaffordable for many Ecuadorians. This means that the number of suits has actually decreased *in spite* of observed population increases.²⁷ Or, as one report explained, "the cost of the fees has been high enough during a time of economic crisis that the population appears to prefer to give up the opportunity to sue for its rights, reducing the demand for formal services."²⁸ Also, as with other challenges, the issue of accessibility to low cost legal services appears to be more aggravated in rural zones, where only 3 of the country's 103 subsidized legal service programs are located.²⁹ And, while these structural changes are focused on, it is also important to encourage more micro reforms, such as the courts' current fee system, which requires that fees be collected before a case is tried, so that the burden of payment often unfairly falls on the party seeking to claim a right rather than the party that is eventually found guilty.

c. Absence of an independent, impartial, accountable judiciary

The high politicization of its courts is another factor driving Ecuador's need for judicial reform. The importance of an independent judiciary cannot be overstated – "the independence of judges is an essential condition for impartiality in the administration of justice."³⁰ Thus, no reform initiative should be considered successful unless it first ensures that judicial decisions reflect the

²⁵ Technical Note (TN), "Estado de Derecho", 1-43: 33.

²⁶ Technical Note (TN), "Estado de Derecho", 1-43: 34.

²⁷ World Bank, "Ecuador: An Economic and Social Agenda in the New Millennium," 516.

²⁸ World Bank, "Ecuador: An Economic and Social Agenda in the New Millennium," 516.

²⁹ Technical Note (TN), "Estado de Derecho", 1-43: 33.

³⁰ World Bank, "Ecuador: An Economic and Social Agenda in the New Millennium," 519.

merits of the evidence submitted rather than conditions associated with the exercise of political power.”

In recent years, Ecuador’s judicial institutions have become a tool frequently used by political stakeholders to maintain their hold on the balance of power in the country. The absence of an independent, impartial, accountable judiciary has promulgated this abuse. One need not look further than the recent use of legislative and judicial proceedings to depose constitutionally elected presidents for requisite evidence. History has proven that it is near impossible to guarantee the independence – external or internal – of the judicial system in Ecuador. According to the World Economic Forum’s Global Competitiveness Report, Ecuador’s judiciary scores 1.9 out of 7 points in terms of its power, meaning that the judicial branch is, to paraphrase, greatly susceptible to influence by members of the government, citizens, and businesses.³¹

Traditionally, the Supreme Court (CSJ), whose members were appointed by Congress, has exercised judicial review in Ecuador. Constitutional reforms in the late 1990s attempted to improve the judiciary’s independence by removing the power of appointing judges from the hands of the Ecuadorian legislature and giving the Supreme Court itself the right to make lifetime appointments to the bench. “In theory, the new system was meant to reduce incentives for strategic behavior and politicization of the Supreme Court while clearly separating constitutional issues from technical appeals.”³² In practice, however, these reforms only entrenched the bias of the Court, and provided no incentive for sitting judges to make appointments that might shift or even destroy existing political alignments on the bench.

The second body designed to conduct judicial review in Ecuador is the Constitutional Tribunal (TC). Created in 1997 to provide constitutional oversight and control independent of the three government branches, as with the Supreme Court, the greatest problem with the Constitutional Tribunal has been Congress’ persistent control of it. “The TC consists of nine members: two are elected from a short list of three nominees submitted by the president, two come from the three candidates presented by the CSJ (who are not CSJ magistrates), two from the National Congress (who are not legislators), one from those presented by mayors and provincial authorities, one from the candidates presented by labor unions, peasants and indigenous organizations, and one from the Production Chambers.”³³ In the end, however, since all appointments must be ratified by a simple majority of the Congress, the composition of Constitutional Tribunal has largely remained a congressional prerogative, and has not presented as much a challenge to the status quo as originally intended.

Beyond regulating the composition of the Court, however, the TC has some important responsibilities, but responsibilities that it tends to acknowledge with action only infrequently.

³¹ Technical Note (TN), “Estado de Derecho”, 1-43: 26.

³² Acosta, et al., “Veto Players, Fickle Institutions and Low-Quality Policies: The Policymaking Process in Ecuador (1979-2005),” 1-76: 26.

³³ Acosta, et al., “Veto Players, Fickle Institutions and Low-Quality Policies: The Policymaking Process in Ecuador (1979-2005),” 1-76: 28.

The Tribunal conducts judicial reviews of ordinary and organic laws, decrees, statutes, ordinances, regulations and other resolutions issued by government institutions. It does not, however, usually have the power to review rulings of the judiciary, and although it has the capacity to rule on the constitutionality of bills during the legislative process, the Tribunal tends to be very selective with such activism. What is most notable is that the contents of the TC's rulings suggest a bias towards partisan demands, particular social movements and individual interest groups. In late 1999, for example, in an attempt to prevent a massive devaluation of the national currency, the Mahuad Administration declared a yearlong deposit freeze. The Tribunal agreed to hear constitutionality complaints filed by several legislators and deposit holders on this matter, which claimed that the state could not confiscate individual assets or act against private property. Eventually, the Tribunal sided with the deposit holders, in a move that both undermined the Administration's actions and put extreme pressure on both the banks and the government's already stretched finances.³⁴

d. Limited availability of alternative methods of conflict resolution

Another key characteristic of Ecuador's judicial system is the fact that existing channels for alternative conflict resolution are very limited, offering few options to the problematic judicial system. Since 1997, 67 mediation centers have been registered with the Supreme Court, but still, especially in rural zones, the demand for such services greatly outpaces the supply. And, it is in these same zones where local officials have been known, in the absence of available courts, to act outside the scope of their legal powers by serving as judges at the request of one of the parties to a hearing, with no legal authorization to do so.³⁵

e. Poor channels for due process

With the persistence of the factors outlined above and the near elimination of stable channels for due process in the country, Ecuador's judiciary system has become almost synonymous with poor legal predictability. In terms of goods, contracts, and obligations, potential actors see little assurance of due process in the system, should the time arise when such services are needed. As a result, Ecuador's investment climate and internal as well as external actors' tolerance for risk has suffered. Without the presence of a healthy judicial system to serve as an "enforcement technology" and provide tangible channels for ensuring that legal commitments are met, actors have come to view operations and the investment climate in Ecuador as unstable and exceedingly risky. And, with these weak channels for due process, there is little security that the means will be available to remedy any failure to meet a legal commitment that might arise.³⁶

³⁴ Acosta, et al., "Veto Players, Fickle Institutions and Low-Quality Policies: The Policymaking Process in Ecuador (1979-2005)," 1-76: 43-44.

³⁵ World Bank, "Ecuador: An Economic and Social Agenda in the New Millennium," 516.

³⁶ Acosta, et al., "Veto Players, Fickle Institutions and Low-Quality Policies: The Policymaking Process in Ecuador (1979-2005)," 1-76: 12.

C. Corruption

In 1996, Ecuador signed the Inter-American Convention against Corruption. Although the Convention was ratified the following year, the Legislature failed to simultaneously amend national law to reflect the provisions of the Convention. This case is just one example of the disconnect between policy construction and implementation that has made corruption one of Ecuador's biggest public (and private) sector challenges. Traditionally, few preventative policy measures have been taken to address corruption – “standards of conduct for the exercise of public offices in which conflict of interests situations are clearly identified have not been defined, nor are there systems to protect those who in good faith report acts of corruption.”³⁷ Also, no anticorruption policy exists in Ecuador's justice sector. In the absence of an adequate institutional response to corruption, problems are addressed on a “case-by-case basis through measures taken after the fact whenever misconduct is discovered for any reason, but neither the judiciary nor the Office of the Attorney General has internal monitoring systems that...allow it to identify cases of corruption.”³⁸

One recent survey concluded that whether the indicator used to measure corruption was evidence of clientalism or biased tariff regimes, corruption in Ecuador is frequently present in public and private sector operations. In fact, the same survey found that the greatest degree of corruption might be in the country's tariff policies, which not only suffer from poor regulation but also seem to foment abnormal levels of corruption at the highest levels of political and economic operations. Beyond direct consequences, corruption is also clearly correlated to distortionary secondary impacts ranging from the exacerbation of poverty and inequality to the reduction of tax revenues and the resources available to society.³⁹

a. Clientalistic practices

Research suggests that in Ecuador, corruption has particular influence over the distribution of government contracts and public services – “an estimated one-third of available public funds are improperly diverted for political reasons.”⁴⁰ A census conducted by the World Bank Institute in 2000 corroborated these findings, identifying corruption as a key concern of the private sector in terms of ensuring the viability and success of business operations and development. “More than fifty percent of the companies surveyed gave the worst possible rating to corruption” when rating a series of obstacles to business development.⁴¹

Surveys conducted on the topic of corruption in Ecuador demonstrate a clear perception that as the amount of time and number of required procedures for establishing business operations grow, clientalistic practices increasingly become the only attractive option for businessmen wishing to

³⁷ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 519.

³⁸ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 519.

³⁹ Technical Note (TN), “Estado de Derecho”, 1-43: 6.

⁴⁰ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 411.

⁴¹ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 415.

optimize their time and investments. In fact, a review of operations and policies throughout Latin America concluded that in order to obtain State contracts, only Peru and Brazil have a higher bribe price than Ecuador.⁴² This means that “individual citizens are not the only ones who are penalized by deficiencies in governance: companies also pay a high cost because of corruption. The data indicate that companies spend more in bribes and bureaucratic red tape than on security. Companies indicate that unofficial payments to public servants represent an average of 8 percent of their gross incomes.”⁴³ And small business owners suffer even more from clientalism – “microenterprises (with fewer than 10 employees) pay an average of 8 percent of their monthly income, while large companies (with more than 100 employees) pay less than 2 percent.”⁴⁴

b. Limited instruments and few incentives

Having outlined some of the current problems inherent in the State system above, it should be clear that instruments to fight corruption in Ecuador are limited and few incentives exist for doing so. With a poorly organized judicial system and a weak public sector, there are few channels for recourse on the topic of corruption. The data provided by one World Bank survey suggests that households in Ecuador most often have to pay bribes to gain access to public registry services, running water, electricity, public hospitals, and public education.⁴⁵ Given that these services are often non-elective or the opportunity cost of their absence is much higher than the bribes that must be paid to obtain them, individuals may not see it as an option for them to refuse payment of a bribe.

The data indicates that corruption greatly reduces the distribution of public resources, acting as a type of regressive tax. Recognizing this cost, both companies and households in Ecuador have indicated an interest in contributing resources, often on the scale of those they currently pay in bribes, to further a national anti-corruption strategy. A survey conducted by the World Bank Institute in 2000 found that 85% of the companies surveyed would be willing to pay an average of 9% of their income if this would eliminate corruption.⁴⁶ This figure is slightly above the average percentage that companies report they currently pay in bribes (8%). Similarly, nearly 70% of households stated that they would be willing to pay an average of 12% of their income if such funds could create incentives or instruments sufficient to reduce instances of corruption in the country. This is significantly higher than the 2-3% that households in Ecuador currently report paying in bribes for services. What remains, however, is the ability to create an anti-corruption strategy that successfully incentivizes the offer of communal benefits. Currently, benefits that individuals and companies receive as bribes are substantial on the level of the individual but often harmful to the interests of the majority.

⁴² Although beyond the scope of the assessment here, this same survey did show that Ecuador has achieved substantial gains in one area traditionally plagued by corruption: tax collection and more specifically, its office of “Servicio de Rentas Internas” (see page 6 for more details).

⁴³ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 416.

⁴⁴ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 418.

⁴⁵ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 418.

⁴⁶ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 419.

c. Sense of urgency

“The increasing amount of data from empirical research emphasizes that poor governance and corruption reduce the standard of living and make the distribution of wealth among citizens more uneven.”⁴⁷ The drivers of these conditions must be addressed in order to halt corruption’s disproportional impact on the poor and its negative impact on investment and growth, as well as the limitations it imposes on the quality and accessibility of public services such as health and education. Quite clearly, corruption must also be minimized in order to strengthen support for real economic growth and prevent further disillusionment and antipathy in the political system.⁴⁸ However, perhaps the most important reason for addressing corruption is its potential influence on long-term democratic stability. Recent studies conducted in Latin America countries have proven, empirically, that citizens who have been victims of corruption support their political systems less than those who have not.⁴⁹

Currently, 97% of the companies that work with the public sector report that they have to pay bribes to obtain purchase contracts, and that to win a bid, they must pay on average 15% of the total value of the contract.⁵⁰ These statistics provide a strong motivation for action, especially since data also indicates that corruption perpetuates poverty by acting as a regressive tax on growth indicators. Among other things, corruption handicaps the impetus for growth that infusions of foreign capital and the presence of foreign investors could provide in the domestic economy. As one report concluded, however, bribes can detract potential investors. Data collected for the report showed that companies for which the burden of bribes was highest were those that decided not to invest. In particular, when the difference between local and foreign companies was analyzed, the foreign companies that decided not to invest in Ecuador were also those most affected by corruption.⁵¹

D. Decentralization

A fourth and final key policy focus for Ecuador in terms of reform and modernization of the state structure is decentralization. Decentralization is generally defined as the process through which sub-national government entities are created and endowed with responsibilities including the operation of many public services and the monitoring of regional taxation regimes. Generally, the principal objective of decentralization is to improve the quality of public services – to bring State decisions closer to the general citizenry in order to provide greater incentives for account collection and governmental responsibility at the regional level, while simultaneously improving local control over relevant policy decisions.

⁴⁷ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 415.

⁴⁸ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 426.

⁴⁹ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 425-426.

⁵⁰ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 418.

⁵¹ World Bank, “Ecuador: An Economic and Social Agenda in the New Millennium,” 418.

When effective, the consequences of decentralization can be widespread and can influence numerous areas of a State's operations. In Ecuador, for example, if implemented properly, decentralization could produce improvements in all three of the previously mentioned challenges. Decentralization could improve the accountability, efficiency, and strength of Ecuador's public sector, and improve the quality of services provided by the judiciary while also encouraging greater confidence in the system. Regarding corruption, since "the frequency of bribery varies from one service to the next... [but] it occurs less frequently at the subnational level of government," decentralization could greatly curtail the growth of such problems.⁵²

For Ecuador, any decentralization plan must be tailored to best leverage the strengths of the country's public sector while also building a national strategy to convert the challenges that have slowed the country's development into opportunities for progressive change. The evidence that is available suggests that sub-national governments are more efficient, less corrupt, and inspire more confidence in the populations they represent than the national government. In one survey, 51% of those interviewed expressed confidence in the municipal governments and 47% in the provincial governments. In contrast, 31% of respondents expressed confidence in the national government and 25%, in Congress.⁵³ It has also been argued that decentralization could ease some of the tensions between Ecuador's exceptionally strong, independent regions and the national government – both in terms of policy representation and in terms of achieving a better alignment of interests. With a greater input at the regional and provincial levels, the hope is that decentralization could strengthen the representational accuracy of public policies and government activities, and thereby create a more stable governance system for the country.

For Ecuador, decentralization can also provide a framework to address two of the specific challenges facing the country: the poor allocation and minimal accountability of resources and the disequilibrium between regions in the country.

a. Poor allocation and minimal accountability of resources

In comparison to neighboring countries, Ecuador is burdened by a poor allocation of government resources with minimal safeguards for accountability. In order to improve the quality of government representation by increasing accountability, decentralization has been sold as a model that can bring governance closer to the polis. By providing the means to increase the roles and responsibilities of Ecuador's sub-national governments, decentralization proposes to channel a greater percentage of power to those government officials who operate at the regional levels, and who surveys suggest are less corrupt and inspire credible with the general population.⁵⁴

Traditionally, Ecuador's high degree of fiscal centralization has been greater than that of its neighbors – traditionally, the national government has received about 65% of total government

⁵² World Bank, "Ecuador: An Economic and Social Agenda in the New Millennium," 411.

⁵³ Technical Note (TN), "Descentralizacion", 1-41: 7.

⁵⁴ World Bank, "Ecuador: An Economic and Social Agenda in the New Millennium," 421.

revenue and represented about 66% of total government spending.⁵⁵ To address this imbalance, the government passed a law in 1997 to decentralize funding. The “Ley del 15%” stipulated the transferal of 15% of the government’s annual budget to sub-national governments. While theoretically a prudent move, the problem is that in Ecuador, demand has traditionally been used to regulate the transfer of services and competencies from the national government to region entities. This means that the 22 provinces and 219 municipalities have had to request, on a case-by-case basis, responsibilities from the national government that they were legally granted by law. Subsequently, this means that human and institutional capacity for sub-national governance has not been adequately developed in parallel with the redirection of funds orchestrated by the “Ley del 15%.” And, as a result, the central government has remained disproportionately responsible for public sector operations and services throughout the country although its budget has been decreased by 15%. Thus, it remains to be seen whether this move to transfer funds, while conceptually a move to financially empower regional governments, will be matched with an equal transferal of responsibilities in order to actually empower regional actors to take on more protagonistic roles for their populations. If this happens, then statistics suggest that decentralization may actually be able to create greater accountability for public resources and spending in Ecuador.

b. Disequilibrium between regions

A second challenge that decentralization could help address is the country’s persistent need for greater equilibrium between the economic and social demands of citizens living outside of the Pichincha and Guayas provinces (about 50% of the total population).⁵⁶ Similar to conditions found in most countries in Latin America, in Ecuador the concentration of the population in a few regions is notorious. The relatively low average population density found in some of the provinces could be a cause for alert in terms of these regions’ fiscal viability and local development potential.⁵⁷ The greatest examples of such risks would be the four provinces that each have less than 86,000 inhabitants (equivalent to .5-.7% of Ecuador’s overall population): Napo, Pastaza, Zamora Chinchipe, and Orellana. These provinces have traditionally depended on subsidies from the national government for survival. Although this lack of self-sustainability has not been viewed favorably, it has also been understood that the benefits of maintaining regional governments and operations – such as strengthening of local communities’ auto-governance, responsibility and the effectiveness of services and local development – outweighed the requisite subsidies.

In terms of addressing these “leakages” in order to strengthen Ecuador’s efficiency of public spending, decentralization opens up various opportunities for maintaining the regional operations while improving the quality and cost of such services. One option would be to group the provinces with the lowest population densities together and below a framework that encourages them to operate as annexes of more populated provinces. With this structure, the larger provinces

⁵⁵ Technical Note (TN), “Descentralizacion”, 1-41: 5.

⁵⁶ Technical Note (TN), “Descentralizacion”, 1-41: 7.

⁵⁷ Technical Note (TN), “Descentralizacion”, 1-41: 9.

might also be able to serve as mentors to the smaller ones. This option could help the smaller provinces improve their levels of investment in infrastructure and services, which have traditionally remained low due to their own fund limitations. This option, however, would only work with safeguards to ensure that the larger provinces truly take the policy and investment priorities of their smaller annexed members into account. Here, a second option might be for the central government to use decentralization to increase skill transfers to the least populated regions. This could possibly be done by making the funding for programs directed at human capital growth linked to more traditional fund transfers. This strategy would not only offer greater accountability for spending but could also create an incentive for local economic development if the release of funding tranches are contingent upon regions meeting a series of development indicators.