The Political Economy of Crisis and Reform in Ecuador, 2000-2005

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by

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Abstract

Ecuador is tiny, heavily indebted, strategically insignificant, and was desperate for finance following a deep crisis in 1998-2000. The IMF is widely seen as 'all-powerful', and keen to exploit weaknesses to extract policy concessions. Given this, why was the IMF unable to achieve success on virtually any of the structural reforms it attempted to impose in Ecuador between 2000 and 2005? This thesis aims to explain this reform stasis following crisis in Ecuador. The investigation centres around a 'veto player analysis', a useful tool which has been underused in the political economy of reform literature. The thesis develops the concept and shows how it can be applied empirically, showing where veto power came from and how players constructed their own power. Seven cases of failed reforms are investigated: tax reform, civil service reform, LPG subsidy removal, customs reform, telecommunications and electricity privatisations, and reforms in the oil sector. These are compared to cases of relative 'success'. The analysis finds that policy stasis was due to a proliferation of societal and legislative 'veto players', who drew on the chronic instability of the Ecuadorian political system and took advantage of executive incapacity to issue credible threats to individuals and even entire administrations. Instability is found to facilitate each of these factors impeding reform. These findings throw doubt on an idea conventional in the literature, that economic crisis catalyses economic reform. The thesis argues that paradoxically, instability is at the root of policy stasis in Ecuador, and that in exacerbating instability, crisis impedes reform rather than catalysing it.

I hereby certify that this thesis is the result of my own work except where otherwise indicated and due acknowledgement is given.

Signed: Date: 27 May 2007

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List of Acronyms

21st of January Patriotic Society Party (*Partido Sociedad Patriótica 21 de enero*)	PSP
Andean Development Corporation	ADC
Democratic Left (*Izquierda Democrática*)	ID
Ecuadorian Roldosists Party (*Partido Roldosista del Ecuador*)	PRE
Enhanced Structural Adjustment Facility	ESAF
Financial Responsibility and Transparency Act	FRTA
General Manager	GM
Heavy-Crude Oil Pipe (*Oleoducto de Crudos Pesados*)	OCP
Inland Revenue Service	IRS
Institutional Renewal Party of National Action *(Partido Renovador Institucional Acción Nacional)*	PRIAN
InterAmerican Development Bank	IDB
International Financial Institutions	IFIs
International Monetary Fund	IMF
Liquid Petroleum Gas (*el gas*)	LPG
Ministry of Economy and Finance	MEF
National Modernisation Council	Conam
Popular Democracy (*Democracia Popular*)	DP
Popular Democracy Movement (*Movimiento Popular Democrático*)	MPD
Quito Electricity Company *(Empresa Eléctrica Quito)*	EEQ
Social Christian Party (*Partido Social Cristiano*)	PSC
Transecuadorian Pipeline System *(Sistema Oleducto Trans-Ecuatoriano)*	SOTE

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Introduction

When a wave of reform swept Latin America in the 1980s and 1990s, it missed out Ecuador. While Chile, Argentina, Mexico and others introduced wholesale changes to move from an import-substitution to an export-oriented paradigm, Ecuador stuck to business as usual. Reform has been limited to some trade, capital and exchange liberalisation. Today, Ecuador still suffers from a low tax take, an overdependence on oil revenue, a heavy debt burden and highly distortionary, inefficient and regressive price controls. Unlike other Latin American countries, Ecuador has privatised virtually nothing, and even second-best attempts to introduce private administration failed. The inefficiencies and vulnerabilities of Ecuador's economy have been masked by a series of booms—coffee, bananas, shrimp, and, most recently, oil—which have kept the country constantly oscillating between prosperity and crisis. In short, Ecuador remains 'unreformed'.

This was not for want of international pressure. Over the last 25 years, Ecuador has had numerous IMF programmes. But although Ecuador signed up to agreements readily, it did not implement reforms with the same enthusiasm. Only three of Ecuador's nine Letters of Intent since 1980 were ever deemed 'completed' (the last dubiously).[1] Six were cancelled prematurely.

It seems strange that Ecuador could defy the IMF this way, agreeing on reforms and then failing to implement them. It seems especially strange since Ecuadorians of varied political persuasions tend to view the IMF as all-powerful. Most of the participants in a set of World Bank workshops in 2001 thought that "the Ecuadorian government makes decisions in response to the pressures coming from the IFIs, whose only interest is to secure the payment of the external debt."[2] Ecuador's 2000 IMF agreement was summarised by one newspaper as "less like an assistance plan and more like a blue print for a financial *coup d'état.*"[3] The President of the Popular Front, an umbrella organisation of leftist movements, called the 2003 Letter of Intent a "letter of slavery against the Ecuadorean people";[4] a later President said the

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[1] Ecuador had stand-by credit agreements in 1983, 1985, 1986, 1988, 1989, 1991, 1994, 2000, 2003 as well as nine throughout the 1960s and 1970s. Only those in 1981, 1984 and 2000 were declared completed; the 2000 agreement for political reasons explored in this thesis.
[2] SAPRI (2001).
[3] Palast (2000).
[4] World Socialist Website (2000).

"IMF and World Bank dictate every detail of spending".[5] One Ecuadorian economics professor called Ecuador, "an obsequious pupil of the IMF"; another felt "everything that has been done here has been a response to the pressures of the IMF and the World Bank."[6] A social historian, Enrique Ayala, said that Ecuador could not pass a single economic law without consulting the IMF: "The current government hardly negotiates Letters of Intent with the IMF. The negotiations for the latest one lasted just 15 days... The basic policies of this country are determined by the IMF. That's undeniable."[7]

Outside Ecuador, the IMF is similarly described: "neo-colonial", "forcing weaker nations to reform", giving countries "no choice but to implement the painful measures demanded by the Bank and Fund", "no choice but to go cap in hand", "no choice but to submit to external dictates", having effective control of third world economies ("sign or starve"), of being a "de facto global regime" which acts with "utter ruthlessness", a de facto "branch of government" in third world countries.[8] Measures are "demanded" and "imposed", and the IMF issues "commands" and "diktats".[9] *The No-nonsense Guide to Globalization* claims conditionality gives the IMF "a degree of control that even the most despotic of colonial regimes rarely achieved".[10]

This view of the IMF as all-powerful conflicts with academic studies which reveal a "woefully weak" enforcement record.[11] Early studies found that IMF programmes frequently broke down, that compliance was poor, and that there was little "revealed influence" on the macroeconomic variables studied.[12] Then, an IMF review in 1997 found that only a quarter of all three or four-year arrangements were completed "without significant interruption".[13] After reviewing a mass of studies and evidence, Killick concludes that "domestic political calculations dominate decisions about economic policy changes and donor agencies (including the IMF) are relatively

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[5] Interview, Ernesto Castillo Gonzalez, President of Ecuador Popular Front, 5 June, 2003, Quito.
[6] Interviews, Quito and Guayaquil, 2003 and 2005.
[7] Interview, Enrique Ayala, 28 March, 2005, Quito.
[8] Cavanagh, Welch et al. (2000), Bello and Cunningham (1994), Denny (2002), Valisno (2005), Palast (2000), Moore (1999), Palast (2000).
[9] Leech (2003).
[10] Ellwood (2002). The extreme left uses the most radical discourse: one article claimed that "officials of these agencies can hold an entire population to ransom", "around 90 countries are effectively governed from Washington by the Fund and the Bank" and that in Africa, "most governments are under the command of the debt agencies" (Socialist World 2004).
[11] Willett (2001). See also Killick (1995a), Haggard (1992), Bates and Krueger (1993).
[12] Killick (1995b). Mussa and Savastano (1999). Edwards (1989).
[13] IMF (1997).

powerless".[14] Nelson came to a similar conclusion.[15] What is going on here? It seems that countries that defy the IMF are not so rare after all. Perhaps if we can account for the failure of reform efforts in Ecuador, we can shed light on a common occurrence.

In fact, the inability of the IMF to effect change is especially puzzling in Ecuador's case. One might expect Ecuador to fall into the category of countries the IMF *does* influence, since it seems weak and powerless in every way. Firstly, Ecuador is 'small enough to fail', its GDP less than 0.1% of world GDP. Even its biggest source of export income, petroleum, is insignificant in global terms (0.7% of world production[16]). Ecuador is also geopolitically weak, close enough to the US to be heavily influenced by it, but with little of political significance to offer. The American Embassy in Quito tends to have strong influence both in domestic Ecuadorian politics and in the IMF, which one might expect to amplify IMF influence.[17] Furthermore, Ecuador has been an official 'prolonged user' of IMF resources for four decades,[18] so generations of Ecuadorian officials have worked closely with the IMF, and many have become true believers in Fund prescriptions. Perhaps most significant is the severe banking, currency and political crisis Ecuador suffered in 1999. By 2000, Ecuador's debt was $13.7 billion (130% of GDP), making Ecuador the third most heavily indebted nation in Latin America.[19] Following Ecuador's 'dollarisation' in 2000, when the sucre was replaced by the US dollar, Ecuador lost control of monetary policy. This meant Ecuador was unable to devalue, and became even more dependent on external finance. To make matters worse, private financing options were effectively closed in 1999 when Ecuador defaulted on $6.6 billion in Brady bonds.[20] By 2000, the only option left was public finance, and the gatekeeper to it all was the IMF.

And yet IMF reform was repeatedly blocked and reversed. IMF programmes were cancelled even when attached to large sums of money and attempted during

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[14] Killick (1998:151-2).
[15] Nelson (1990:330).
[16] *Offshore Environment* (2005), *Latin Business Chronicle* (2005).
[17] A convincing mass of literature shows that the US can use its influence in the IMF to advance its political agenda through its voting power, the system of special majorities, and various other conventions. See, for example, Frey (1997), Swedberg (1986), Goricki (1999). On special majorities, see Lister (1984). On other means of influence, see Lichtensztejn and Baer (1987); Kahler (1990), Eckaus (1986), Stiles (1991), Ruggie (1993).
[18] IMF (2002)
[19] After Argentina and Nicaragua, as a percentage of GDP, in 2000 (Lapper 2000).
[20] Even four years later Ecuador's debt was officially rated 'highly speculative'. By April 2005, Ecuador's debt was still rated CAA1 by Moody's, the same grade as Argentina.

times of crisis and prosperity; agreed to by pliant and defiant Presidents, and by united and divided economic teams. The IMF—a large, well-resourced international institution with unparalleled access to financial incentives for reform—was unable to achieve success on virtually any of the structural measures it attempted to impose between 2000 and 2005. From 2000 to 2002, Ecuador's President Noboa agreed to a radical, ambitious IMF programme but was unable to implement *any* structural reforms, even those which did not require congressional approval. Noboa's successor Gutierrez not only also failed to complete an IMF standby arrangement in 2003, but just a year later attempted to pass the same IMF reforms without an IMF agreement—that is, promoting IMF-style reforms, but not seeking IMF financing in return. This approach, too, failed.

How did a tiny and heavily-indebted nation in crisis resist the IMF? This thesis aims to explain the inability of the IMF and Ecuador to implement the reforms to which they repeatedly commit. The investigation serves as a lens through which to examine the political economy of crisis and reform in Ecuador more broadly. By closely examining IMF structural reforms attempted by the Noboa administration (2000-02) and the Gutiérrez administration (2003-05), considering the political economy of the relationship the interaction of various underlying political and societal features of Ecuador and the incentives faced by various 'veto players', I aim to shed light on the relationship between crisis and reform in Ecuador.

Chapter One: Conceptual Framework and Methods

When a wave of neoliberal reform swept the world in the 1980s and 1990s, some islands of resistance remained. Why one such island did so is the subject of this thesis. Before addressing the specifics of the case, it is worth considering why we might expect reform in the first place. Specifically, why might we expect a weak, post-crisis country to implement an IMF programme?

Two political economy literatures suggest why we might. The first predicts that weakness would drive a country to capitulate to IMF suggestions, while the second predicts that as a country emerges from crisis, its domestic political configuration is particularly conducive to reform. Combining the two might reasonably lead us to believe that such a country would reform along the agreed (IMF) lines.

In the first of these literatures, IMF negotiations are seen as a process of 'bargaining'. Each side makes as few policy concessions as possible while extracting the best possible financial terms.[1] Relative power is the key analytical variable: the more powerful actor makes more concessions. A clear example is Bird and Rowlands:

> "Assuming that governments attach utility to IMF loans but disutility to IMF conditionality, the outcome of negotiations depends on the relative bargaining strengths of the Fund and the governments with which it is negotiating. A country desperately in need of foreign exchange but with no alternative source of supply will be in a weak bargaining position, especially if is small economically, strategically insignificant, and lacking allies amongst the Fund's major shareholders."[2]

Power is operationalised in several ways, including strategic significance or 'importance',[3] size,[4] indebtedness, and access to other 'nonconditional financial

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[1] Odell (2000) admits the possibility of 'value creating' in international economic negotiations but says it is rarely observed.
[2] Bird and Rowlands (2003:1261).
[3] Measured as size of IMF quota, US foreign aid, other aid in Stone (2002).
[4] Measured as IMF quota in Edwards (2001).

resources'.[5] This literature thus predicts that the weaker the country, the more readily it will agree to reforms at the international level.

Meanwhile, a second literature concentrates on countries emerging from crisis. This literature predicts that economic crisis will catalyse reform implementation at the domestic level. Olson argues that societies have a natural tendency to become 'sclerotic' as the power of pressure groups rises and policy makers are captured, but that crisis disrupts this system.[6] Drazen and Grilli argue that the welfare losses in economic crises allow societies to enact reforms that would be impossible to achieve in less distortionary circumstances.[7] Economic crises create a demand for adjustment, so that more people are willing to make sacrifices for stability.[8] Others place less emphasis on erosion of political capital or structures and more on experts, policy makers, politicians, the media, and the general public 'learning' from mistakes.[9] For Corrales, hyperinflation is "the ultimate pedagogical experience".[10] He also depicts economic crises as "clearing the way" for reform, along with similar metaphors: severe crisis is "an earthquake", and hyperinflation is an atomic bomb, leaving "no single structure from the old world". Rodrik talks of an "intellectual ground" which was "cleared for the wholesale reform of prevailing policies", the slate "wiped clean".[11] Finally, Haggard notes that crises expand the group of 'potential winners', facilitating reform. Since the benefits of reform—halting hyperinflation, for example—are "immediate and broad", reforms during crisis can be more radical. Haggard also predicts crisis might influence 'bargaining', with more radical reforms agreed at the international level since delegating responsibility to negotiators enhances the credibility of politicians in the eyes of foreign creditors, including the international financial institutions (IFIs), whose support and funding is even more crucial during crisis.[12]

At times this hypothesis has produced startling policy implications. Drazen and Grilli, for example, argue that crises may *improve* welfare in the long run, where

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[5] That is, non-IMF sources of finance, as in Haggard and Kaufman (1989).
[6] Olson (1982).
[7] Drazen and Grilli (1993).
[8] These sacrifices are often portrayed as collective actions: "if the government is bankrupt... all politicians, regardless of their ideological orientations, electoral programs, and social bases will be willing to do what it takes to restore creditworthiness" (Przeworski 1991). See also Weyland (1996b).
[9] For example, see Tommasi (2003).
[10] Corrales (1997:628).
[11] Rodrik (1996:17).
[12] Stephen Haggard, in a panel discussion as reported by Williamson in Williamson (1994:469).

they are the only means of achieving necessary policy reform and add that crises may be "hence desirable".[13] Krueger argues that the *reforms themselves might be better* if designed during a state of crisis. Her concluding paragraph runs: "The scope for good economic policy analysis in "the public good" seems to have most potential in times of crisis, when decisions as to future policies are less constrained by short-term political forces than is normally the case".[14] The idea that crisis aids reform has become common in the literature,[15] and has been expressed by commentators on the Ecuadorian case.[16] Corrales generalises the point: "In fact, so conventional is this view that some international policy advisers have actually been known to recommend to policy-makers that they wait until things get really harrowing before launching [adjustment] reforms".[17]

The propositions of the two literatures are complementary: relative weakness will encourage *agreement* to reforms, and crisis will catalyse *implementation* of reforms. The crisis literature says little about what kind of reforms would be catalysed, but we might expect it would be those agreed to in international negotiations, especially given the financial incentives offered for completion and that they are offered just when recipients are particularly desperate for finance. Given all this, we might expect an IMF programme attempted in a weak, post-crisis context to be completed. Yet, the introduction showed Ecuador was both weak *and* non-reforming, a combination not predicted by the model. How can we account for the existence of weak, post-crisis non-reformers?

Research from the IMF itself is a good starting point for explanations of non-completion. These studies tend to link programme non-completion to domestic variables, especially instability, ethnic homogeneity, programme 'ownership' and 'commitment' to reform.[18] An IMF review of the literature concluded that "commitment to reform" was crucial for successful completion, and blamed two-

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[13] Drazen and Grilli (1993:598-9).

[14] Krueger (1992). Compare Krueger's prescription here with Stiglitz' observation that "The proclivity to resort to centralized control [during crises] seems particularly odd, given the widespread perception, at other times, that government bureaucracies are subject to delays and inefficiencies. Why should an organizational form that is so maligned in normal times suddenly become virtuous?" (1997:166).

[15] In 1997, Corrales said that the argument that "economic crises are a blessing in disguise, since they contribute to the adoption and successful implementation of harsh [adjustment] measures" was not only "conventional" but had "become almost indisputable" (1997:617).

[16] In 2002 the IMF refused to enter into a new standby arrangement while Ecuador was spending irresponsibly, and an economist reported, "Some say it would be cathartic to leave them to it and see what a mess they get themselves into" (Moss 2002b). More than one interviewee expressed a similar sentiment in 2005.

[17] Corrales (1997:620).

[18] For example, Schadler, Bennett et al. (1995).

thirds of Enhanced Structural Adjustment Facility (ESAF) programme interruptions on "serious policy slippages" that weakened the government's credibility or produced "protracted disagreements" between the IMF and the government.[19] In transition economies, the Fund found five further reasons for non-completion: a lack of monitoring expertise in unfamiliar areas as conditionality expanded; poor administrative capacity; vested interests benefiting from partial reform; occasional agreement "out of desperation" by authorities who could or would not implement the agreed measures; and excessive, un-prioritised conditionality which countries felt able to violate without endangering the programme as a whole, resulting in superficial and selective implementation.[20]

The explanatory power of these in-house studies is often limited, however. 'Policy slippages' is a rather tautological explanation of programme interruptions, and not really aided by the explanation of the cause of these policy slippages (political upheaval and, again, "flagging national commitment"). Furthermore, many IMF studies rely on econometric models which reveal important domestic variables but do not develop theory to explain their causal significance.[21] Some of the variables need to be carefully resolved—for example, both political changes[22] and long-term incumbency[23] have been found to inhibit reform. Regarding the ESAF interruptions, it is not terribly helpful to conclude that a programme broke down because the government was not implementing it, that this led to disagreement with the institution whose programme it was, and that programme implementation stopped because the government was not trying hard enough. Finally, while several of the transition country findings seem sensible, they do not really *explain* either domestic-level processes or aspects of the IMF interaction. Why do factors like low administrative capacity and excessive conditionality persist? Why might authorities agree 'desperately', and why does the IMF not notice that this dooms the programme?

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[19] Boorman (2001).

[20] Boorman (2001:53-4).

[21] For example, Mecagni (1999) emphasises political changes and civil instability. Dollar and Svensson (2000) a World Bank study, found that reform success was most likely in ethnically homogenous, stable democracies, and that long-term incumbents inhibited reform, and therefore recommended that the Bank try harder to understand these political economy variables. Ivanova, Mayer, Mourmouras and Anayiotas (2001) used a similar (econometric) methodology regarding IMF programmes and obtained similar results: completion was related to political cohesiveness, ethnic fragmentation, conflict, and the power of special interests. See also: Dollar and Svensson (2000); Burnside and Dollar (1998); World Bank (1998).

[22] Mecagni (1999).

[23] Dollar and Svensson (2000).

The answers to these more fundamental questions and some more compelling accounts of non-completion are suggested in a vast literature on the 'political economy of reform'. Within this, two particularly well-developed subliteratures examine domestic-level factors that block or catalyse reform: 'interest group' analysis and 'institutional' analysis. Both literatures draw mainly on transition, African, and Latin American area studies and on the politics of reform in developed countries. In this review, I privilege the Latin American literature since the Ecuador case contributes to it.

Let us begin by considering how the 'interest group' subliterature explains non-completion. This literature, which developed out of early pluralism, explains non-completion in terms of the tension between particular and collective interests. It focuses on the way interests are aggregated and mobilised, how group preferences are formed, and how power is distributed among societal and state actors. The interest group literature is huge and rich; here, I highlight three particularly useful insights. These help explain why even 'winners' might oppose reform, why those opposed to reform might win even though outnumbered, and why the reform window is small in democracies.

The first insight aims to explain why groups might prefer the status quo when we predict they will not. Most explanations assume preferences will be based on rational economic interest: that consumers want more and cheaper goods, labour unions want higher wages, and so on. But the best accounts supplement economic, rational, logically 'derived' preferences with anthropological, empirically 'discovered' preferences. Such studies have found that consumers might prioritise unexpectedly,[24] and unions might be unexpectedly strategic.[25] Highlighting the poverty of "thin, simplistic" analyses of rationality and preference formation in the traditional interest-based approach, Appel explains how ideological preferences informed the design of privatisation in post-communist transition economies. Appel further noted this was particularly important in a transition context where everything was unclear; this applies equally to a country emerging from crisis.[26] Ganghof (2003) adds a further useful nuance, distinguishing between 'outcome preferences' and

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[24] Vogel (1999) explains why Japanese consumer groups had apparently opposed their own rational economic interests.

[25] Stahler-Sholk (1995) explains why Nicaraguan labour unions sometimes restrained their opposition in terms of the evolution of their own definition of their interests and the strategic calculation of their interests.

[26] Appel (2000)

'positional preferences'. The first concerns the material or policy result, the second concerns strategic manoeuvring in terms of relative political power, deferring immediate gain for the prospect of larger future gain (for example, ahead of a re-election). These combine to form aggregate revealed preferences. This literature therefore explains groups' apparent opposition to their own rational economic interest in two ways: for some groups, other interests are more important, and some groups can delay economic gratification and eventually achieve a larger reward.

The second insight explains why those opposed to reform might win even though outnumbered. Many (neoliberal) reforms concentrate losses and disperse gains. As Olson (1965) showed, even though we might expect this to increase support for reform since more individuals win than lose, in fact diffuse interests often lose because they lack incentives to organise and are too numerous to organise effectively. A few 'losers' can successfully mobilise against reform if the many 'winners' have no idea they were about to win or see their potential winnings as not worth the effort of protecting. Krueger's pioneering work has been influential in explaining the 'loser' side of the equation. She showed how rent-seeking, especially in developing countries, could be more profitable than productive activity and how rent-seekers thus have a vested interest in blocking reform.[27] Hellman used these concepts to develop an influential analysis explaining partial reform, drawing on the experience of transition economies: initial reform creates market distortions, whose beneficiaries capture key organs of the state and block further reform to preserve their rents as long as possible.[28] Bird and Rowlands point out that it is perception that matters—even if groups would gain from a policy, if they believe they would (or even might) lose, they will likely defeat reform.[29] This is important because in situations of transition or crisis, who will win and who will lose is often unclear.

The third insight is that electoral cycles constrain the window of opportunity for reform in democracies. Losses often precede gains from reform, so the losers have time to argue no gains will ever materialise, resulting in a structural bias against reform in democratic systems, as politicians have an incentive not to embark upon any reform whose benefits will not materialise before the next election. From this came

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[27] See, *inter alia*, Krueger (1974).

[28] Hellman (1998). Havrylyshyn and Odling-Smee (2000) provide an explanation of stalled reforms in transition countries similar to Hellman's, centred on 'powerful vested interests' who gain rents from partial reform. They also provide potential channels of change which could overcome these vested interests: a strong leader, a growing middle class, and external pressure from foreign competitors, foreign investors, or IFIs and bilateral donors.

[29] Bird and Rowlands (2003:1267).

the concept of the 'honeymoon', a period in which a newly-elected government could enact unpopular reform.[30]

These three insights help explain why even 'winners' might oppose reform, why those opposed to reform might win even though outnumbered, and why the reform window is small in democracies. However, clearly reform does occur sometimes, and even well-organised vested interests can be overcome. As several studies show, elites can shape reform content to manipulate the size, power and preferences of groups within society and by doing so can solidify their own position.[31]

This thesis is interested in a particular kind of *stasis* in which reforms are attempted but not completed. Within the interest group paradigm, this means we must focus particularly on why some groups are always successful in opposing reform but do not prevent reform getting on the agenda. We need to chart a middle course, explaining firstly why elites could not overcome groups or change the preferences of those opposed to reforms, and secondly why this did not entail 'state capture' (that is, either reforms proposed and completed by these groups themselves or to no reform proposals at all).[32] One section of the literature focuses on a subset of vested interests who can block reform at will but not necessarily keep it off the agenda: 'veto players'. I briefly explain the 'veto player' concept here, and discuss definitions in more depth in the next section of this chapter.

The 'veto player' concept is formalised by Tsebelis (2002). Tsebelis defines a veto player as an individual or collective actor who has to agree for the status quo to change. By definition, reform requires the agreement of all veto players. Tsebelis shows that *ceteris paribus*, the more veto players there are, the more policy stability there will be; that is, systems with a high number of veto players will pass few significant laws. Tsebelis defines two types of veto players: institutional (those formally named somewhere, such as the President, Congress and Senate) and partisan (those whose veto arises from the system but not from its formal rules).[33] Some of

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[30] See, for example, Williamson (1998), and also Haggard, who argues that "acting swiftly at the outset of an administration allows the government to absorb transition costs prior to the next electoral contest and increases the likelihood that politicians will be able to profit from recovery" (2000: 41).

[31] On this, see Murillo's 'political bias hypothesis' (2002) and Chaudhry (1994) similarly on Iraq and Saudi Arabia. Mares (1993) explains reform in terms of the ability of elites to share out rents to key groups in Colombia. See also Moltz (1993) and Young (1992) on Gorbachev's liberalisations.

[32] For an example of the former in Chile, see Silva (1993).

[33] I will add a category later in this chapter: veto players located outside the formal political system, or 'informal veto players'. These veto players are not captured by Tsebelis at all.

these veto players can present 'take it or leave it' proposals to the other veto players. Tsebelis calls these 'agenda setters'. The other veto players are reactive.

Tsebelis is concerned with a stylised explanation of how veto players influence policy reform. He considers only developed countries, and examines legislative reform rather than implementation. He also ignores veto players other than institutional veto players and political parties in order to simplify his model.[34] Applying the concept to a real-world case therefore introduces several new elements.[35] Although Tsebelis excludes real-world veto players ('random noise' like unions, indigenous groups, other civil society groups, and public and private individuals) from his model, he recommends their inclusion in case studies. Tsebelis' analysis of veto players has influenced recent empirical analyses, particularly European[36] and other developed countries[37] and also some Latin American analyses.[38] Unfortunately, Tsebelis provides no guidance for individual empiricists on how to identify veto players, and much of the literature drawing on veto player analysis does not rise to its methodological challenges.

There are two major limitations in the veto player literature: terms are poorly defined and concepts are often not explored fully or elaborated carefully. Firstly, definitions. Some studies seem to use the term 'veto player' indistinguishably from 'interest group'[39] while others quote Tsebelis[40] or offer a fairly unhelpful slight rewording of his definition. Typical of the latter is Gould and Baker's, "A veto player is a person or group whose agreement is required for a new policy to be adopted" or Kay's, "A veto player is an individual or collective actor whose agreement is required for a change in policy".[41] These merely shift the question; how do we recognise a group whose agreement is required? Later in this chapter, I propose a means of operationalising the veto player concept.

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[34] Tsebelis mentions five developing countries in passing, whereas he discusses several developed countries in detail.

[35] I discuss the differences between Tsebelis and my approaches in detail later in this chapter, and draw out their implications.

[36] See, for example, Obinger, Leibfried et al. (2005), Trechsel (2005), Selck and Kuipers (2005), Selck (2005), Busemeyer (2005).

[37] See, for example, Tavares (2004), Ganghof and Eccleston (2004), Crepaz and Moser (2004).

[38] See, for example, Kay (1999), Castiglioni (2001), Alemán and Tsebelis (2005).

[39] For example, Haggard (2000:28).

[40] Castiglioni (2001) cites Tsebelis' definition that a veto player is "an individual or collective actor whose agreement is required for a policy decision" (Tsebelis 1995:293).

[41] Gould and Baker (2002:100), Kay (1999:405).

The second limitation arises from invoking the veto player concept but not exploring it fully. To illustrate this, it is worth discussing one study in depth. A typical example of the way the veto player concept is employed in case studies is Kay's (1999) examination of social security privatisation in Argentina, Brazil and Uruguay, which has influenced several subsequent works.[42] Kay finds that interest group strength in terms of resources, density, and degree of representation does not adequately explain policy outcomes. He therefore investigates veto player analysis as an alternative explanation of his case. Kay's conclusion centres on the role of veto players in social security reform, arguing that a key factor was the way institutions provided interest groups with opportunities to act as veto players.

Kay's approach provides an effective explanation of the policy outcomes he examines, but is limited. It could be improved by clarifying and developing the key concept of 'veto players', those with 'veto power'. As it is, a lack of definition makes some of Kay's terminology mystifying, such as "effective veto players". Is there such a thing as an '*in*effective veto player'; surely an oxymoron? Similarly, Kay says: "Interest groups will have less veto power in systems where the executive branch can bypass the Congress and directly introduce legislation."[43] What could 'less veto power' be? Does this mean a player who can exercise veto *less often*, or *over fewer issues* or that their actions can be *overruled by another party* (in which case Kay actually means influence rather than 'veto')? The lack of clarity around exactly what a veto player *is* reflects a lack of attention to the origins of veto power which is common in the literature. This is important because it constrains such studies' policy implications. Kay claims that government can prevent interest groups "acting as veto players"[44] but does not specify whether this means (a) preventing or persuading a group not to use a veto, or (b) removing the veto itself. The two are quite different, but because Kay neither clarifies nor implies where veto players' power arises from (and hence how it could be removed), the distinction is lost.

A further consequence of the lack of attention to the origins of veto power is that such studies consider only those veto players named in formal, explicit delegations of power (thus linking their origin to institutions only in a very limited

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[42] For example, Christensen and Pallesen (2001), Béland and Man Yu (2004) and Béland (2001). The latter particularly draws on it.
[43] Kay (1999:413).
[44] "Governments were able to implement [privatisation] only where interest groups were prevented from acting as veto players" (1999:413).

sense). Kay gives three factors which increase veto power: weak party discipline (high patronage, open list, low hierarchy), plebiscites and whether opponents of reform hold positions in the institution. These seem reasonable, but while are true by definition (such as when societal groups hold formal veto power in institutions) others are asserted rather than established (why can a government not merely ignore a plebiscite?). More significantly, Kay only acknowledges the veto power of groups outside the legislature through a plebiscite or formal membership of an institution. All his veto players are given power overtly and exercise this power through formal institutions. By considering only explicitly-delegated power, this approach misses a key part of the veto story. In Ecuador, several major veto players do not work through institutions but through public protest. Others work covertly. We need a measure which may be more subjective and more open to argument, but which captures the most significant veto players rather than just the formally-named ones.[45] I return to this point later in this chapter.

If we can find solutions to these challenges, a veto player analysis could be a promising explanation of policy stasis in general. However, we also need to ensure that it explains policy stasis specifically *after crisis*. As we saw, many scholars argue that crisis disrupts normal patterns of collective action (Olson's 'sclerosis') seeing economic crisis as a means of undermining opposition to reform and disrupting patterns of state capture[46], "shocking countries out of traditional policy patterns".[47] Because the crisis hypothesis is so influential in the literature (and, to a lesser extent, in policy-making), and because Ecuador suffered such a major crisis, an account of stasis after crisis should be sure to explain why crisis did not have the predicted effect. We need to account for why veto players might appear and endure, why they are willing and able to continue to exercise their veto even after crisis.

By itself, the veto player literature is insufficient for this task. This is because of the limitation pointed out above: since the veto player literature does not consider the source of veto power, it cannot explain why it endures through crisis. Luckily, the second major political economy of reform literature addressing reform non-completion can assist on this point. This 'institutional' literature sees institutions as

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[45] In a recent InterAmerican Development Bank Study, Mejia-Acosta, Araujo et al. do include informal veto players in their discussion of Ecuador (2004:15). However, like Kay, they do not systematically account for why the specified actors have been designated 'veto players', providing no test or explanation of where their power stems from or why they are taken seriously.

[46] Krueger (1992:354).

[47] Williamson and Haggard (1994:562).

resilient actors shaping the definition of individual interests and setting the parameters of political behaviour. The institutional literature stresses obstacles and continuity over change. In so doing, it offers good explanations of policy stasis. Additionally, unlike the societal literature, several reform inhibition factors mentioned in the institutional literature seem likely to endure or increase following crisis. This could help explain why a country like Ecuador did not reform after crisis.

The factors found to inhibit reform by the institutional literature include the low capacity of weak states (including the low capacity of elites, state institutions, and the bureaucracy), fragmentation, polarisation, clientelism, and a proliferation of undisciplined, unstable, non-programmatic parties. Much of the empirical support comes from Latin American countries, especially Brazil, and also transition economies. Drawing on Latin American research, Corrales (2000) finds that fragmented, highly polarised or deinstitutionalised party systems and political parties with a history of clientelism or statism make reform harder. Weyland (1996a) explains failed social security reform in Brazil in terms of the institutional fragmentation of state and society, persistent clientelism, undisciplined, non-programmatic parties, an internally-fragmented state "ravaged by bureaucratic politics", and groups opposed to redistribution which use their connections to key organs of the state to influence policy. Kingstone (2003) examining privatisation in Brazil, emphasised Brazilian political system's high level of fragmentation and personalist, particularist politics as impediments to reform. In Russia, Roberts and Sherlock (1999) blamed a weak ("feeble, dysfunctional", low-capacity) state for partial reform. Yan Sun (1999) also concludes this after comparing 'strong, united state' China and 'weak, divided state' Russia. While China was institutionally stable, Russia's functional vacuum was filled by the mafia. [48] Some institutional literature examines reform *completion* and emphasises bureaucratic capacity, [49] political leadership, [50] and cohesive, stable, credible political parties.[51]

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[48] See also Allina-Pisano (2004) on weak state effects in transition economies.

[49] On capacity, Williamson notes that good economic policymaking requires a coherent economic team of technocrats backed by a solid political base. Evans (1992) outlines the political and sociological conditions allowing competent economic policy-making bureaucracies. While Evans emphasises bureaucrats' 'embedded autonomy', Waterbury (1992) emphasises bureaucrats' dependence on external political forces, explaining failed reform efforts in Zambia with reference to a lack of executive commitment to support and protect technocratic 'change teams'. Others, such as Geddes, see this debate on the tension between internal and external determinants of bureaucratic performance as misleading: institutions are political creations and their persistence and competence responds to political factors (although Geddes acknowledges that once created, institutions gain their own momentum). See Geddes (1995) for more discussion of the way the creation of institutions has been theorised in the literature.

It seems reasonable that these reform-inhibiting factors could persist despite crisis or be made worse by crisis. That is, crisis could further lower state capacity, increase fragmentation, polarisation, clientelism, and further decrease stability and discipline within political parties. This thesis will put this idea to an empirical test. If crisis does work in this way, institutional explanations might offer a useful explanation of stasis in post-crisis contexts.

This might tempt us to see institutional literature as sufficient to explain policy stasis without investigating veto player analysis further. After all, it could offer compelling explanations of policy stasis and also be resolvable with the crisis literature. But although the institutional literature is useful, it is still partial. Studies drawing only on institutional concepts can be overly parsimonious and limited in their explanatory power. While institutional literature is particularly strong in highlighting constraints on actors, it generally explains reform content only in terms of elite ideology, focussing on individuals' background and personal qualities and often seeing opposition as monolithic and confined to the legislature. For example, Kingstone (2003), in an article firmly in the institutional paradigm, examines the privatisation of Brazil's Telebras by studying Congress and its various committees, technocrats, presidents and their respective personal attributes (one uses 'fiery bluster', another 'an imposition of will'), but barely mentions society.

What is needed, therefore, is to consider how the useful insights of the interest group literature and the institutional literature might be brought together, augmenting veto player analysis so as to account for the effects of crisis. In this thesis, I propose this can be done by carefully operationalising a veto player analysis, capturing all the major veto players and considering the roots of their power. I use the insights of the veto player literature to explain the immediate causes of stasis, and those of the

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[50] On leadership, Sachs calls it "the key reform input that is missing in most economic analyses" (1994:523). Williamson and Haggard argue for visionary leadership even in the absence of social consensus: "if reforms succeed, a social consensus will form in support of their measures; if they fail, no amount of previous social consensus will save them from being cast aside" (1994:575).

[51] Some highlight the role of political parties as vehicles to aggregate diverse views and strike compromises. Drawing on the examples of Argentina and Venezuela, Corrales (2002) argues that the support of the executive by the ruling party is the key to successful economic policy reform. See also Graham, Grindle et al (1999). Parties may also be important for the sustainability of reforms because they can help build credibility and reduce scepticism (Corrales 2002:32). Panizza, Ugo, and Yanez (2003) found a strong relationship between support for reforms and trust in political parties. Reforms are therefore more likely to lose the support of the public in countries where confidence in political parties is low and when implemented by personalistic governments or by unpopular or unstable parties. See also an extensive and related literature examining the reforms associated with democratisation (for example, Whitehead 2002).

institutional literature to explain the deeper roots of where veto players come from and the essential continuities in the process.

As we saw, the literature offers little empirical guidance on identifying a veto player. Consider Tsebelis' taxonomy: 'institutional' and 'partisan' veto players. Identifying the first seems straightforward: 'Institutional' veto players have been given explicit veto power (for example, Congress, via a constitution). However, in Ecuador constitutional documents can be misleading for several reasons. The constitution is unevenly applied and even clear delegations of power can be simply ignored. (Several examples of this are given in Chapter Five). Constitutional oversight is itself highly politicised.

Tsebelis' 'partisan' veto players are those "generated by the political game". Partisan veto players are even more difficult to identify, as Tsebelis himself points out.[52] Parties might be veto players only on a specific issue or at a particular time: If four parties in a five-party system have publicly announced their (diverse) positions and the costs of reneging are high, the fifth party might temporarily become a veto player. In multi-party systems there may be multiple configurations that would produce a majority, so no individual party is a veto player. There may also be unrelated policy trade-offs, and covert and overt legislative coalitions.

Then there are those outside the formal political system, a group not included by Tsebelis at all and which this thesis will call 'informal' veto players or those using 'informal' vetoes.[53] Identification is even harder for this group. In a binary decision, just because a decision has been made does not mean that the opposite was *vetoed.* If more than one player opposes a policy, and the policy fails, how can we ascertain which player, if any, 'vetoed' it? How do we know when the army/bureaucracy/ labour/management (all mentioned by Tsebelis as potential veto players) have vetoed? Let us assume we could discern a veto in hindsight: even then, this does not necessarily indicate ability to veto another policy, or even the same policy later,[54] and it still only allows us to identify (a) groups that have a veto and (b) groups that lack

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[52] Tsebelis gives examples of the army, bureaucracy (2002:35), labour and management (2002:81) as those which might need to be included as veto players in a particular country.

[53] 'Formal' veto players are listed in official governmental documents (the President, for example), while 'informal' veto players are not (a trade union). Similarly, 'formal' vetoes have official weight arising from (documented) procedure (a presidential decree to overrule Congress, for example) while 'informal' vetoes do not (a debilitating illegal strike).

[54] Perhaps, for example, an indigenous group is a veto player when it comes to health policy but not when it comes to oil policy, because although both affect indigenous people, health reforms might have more dispersed costs that allow greater mobilisation of protestors.

one, but try to oppose policies anyway. We also need to be able to identify the group which *is* a veto player, but for whom the proposal falls within the winset. Tsebelis calls Jesse Helms a veto player because he blocked some of Bill Clinton's ambassadorial nominations. If Helms had supported the nominations, would he still be a veto player? How would we know?

We need to be able to distinguish those capable of *vetoing* from those with mere *influence*. Those with influence are not guaranteed their preferred outcome; those with a veto are. The distinction thus turns on the power of veto players to enforce their preferences. The consequences of overruling a veto player must be a major sanction (disincentive) on decision-makers, enough to deter them from attempting to overrule or ignore a veto player. From the decision maker's point of view there are two disincentives big enough to force, not just influence: the threat of removing the decision maker from power, and the overthrow of the formal system itself (for example, declaring oneself a dictator in order to overrule an institutional veto player like Congress). It is important to note that in the second case, the overthrow of the formal system would in fact defeat a veto player. But, of course, there are plenty of other disincentives to overthrowing the formal system, including sparking a chain of events that itself would lead to the decision maker losing power (think of international reaction to declaring oneself a dictator).

For informal veto players, 'Who is a veto player' becomes, 'Who can bring down the government if their attempt to veto is ignored?' Crucially, vetoes do not have to go this far to be effective. Since in the real world this is a repeated game, enforcement is most likely to occur through a credible threat (deterrence). Policy is vetoed by a credible threat just as effectively as by dramatic dissolution of the system itself. Therefore, what matters for veto power is a credible threat: not whether a veto player *really* can bring down a government, but that the government thinks that the veto player can.[55] Veto players may choose not to go so far as to overthrow or threaten to overthrow; in that case, they would be choosing not to exercise their veto. But if they do choose to make a credible threat, veto players need to have a manifest ability to enforce the veto. This connects 'veto power' intimately to 'instability', as the existence of veto players rests on the conceivability of the government falling.

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[55] Examining post-communist transition economies, Appel similarly noted that it was *perceived* power which counted in negotiations, and thus it was important to examine the forces shaping the perception and redistribution of power.

Following this definition, veto players could take a variety of forms and operate in a variety of ways. Some could gain power from specified constitutional documents, others could act entirely extra-legislatively (protests, strikes, pressure on individual reformers), and others could use legislative representation to vote measures down. Veto power could be held consciously and deployed explicitly in personal missives or public statements, or veto players could be unaware of their own strength but still feared by executives who know they depend on their support. In the opposite case, individuals or groups could pretend to hold veto power—but if they cannot deliver, and reformers do not fear their ability to issue credible threats, they are not veto players. Players could create their own veto power by calling on 'big ideas' of fear or promise, such as nationalism and anti-imperialism, to mobilise masses. Shrewd players could seize a moment of instability to establish a precedent for their ability to credibly threaten—or this could happen serendipitously. Appendix A summarises the veto players identified in subsequent chapters of this thesis.

It should by now be apparent that this thesis both develops the veto player concept and also uses it in a wider arena than Tsebelis did. It is worth pausing here to note these contextual differences explicitly, and to examine their impact. The differences fall into three categories: political context, scope, and methodology.

We begin with the differences in political context. Tsebelis situates his discussion in a highly formalised model. When he refers to real-world situations, they involve institutionalised advanced democracies which have stable, predictable political systems and citizens who demonstrate general commitment to legal procedures and rules. Although information flow may not be entirely frictionless, there is an important degree of procedural transparency. Ecuador, in contrast, is a chronically unstable system, and this thesis focuses on a period of particular instability. Furthermore, Ecuadorian political institutions are weak and discredited, and there is little societal and political commitment to legal procedures and rules. There is also a significant lack of reliable information, both about actors' positions and interests and about the rules of the game itself. Even very powerful actors and institutions frequently find themselves in the dark about present and past events. The most basic of public political data—Congressional voting records, for example—can be hard or impossible to access.

It is not that the Ecuadorian system does not *have* rules, but rather that its rules tend to be unwritten and elusive. The bureaucracy does not necessarily carry out executive orders, so we cannot assume implementation of legislated outcomes, as Tsebelis does. In considering Ecuador, therefore, it becomes necessary to enlarge the scope of enquiry to include implementation. While Tsebelis examines only legislative passage and 'endurance' narrowly defined (i.e., whether further laws are enacted to later repeal the law in question), this thesis examines legislative passage and endurance broadly defined (i.e., whether the policy achieved its own stated objectives until the close of the period considered in this thesis, April 2005). The chief theoretical consequence of this expansion of scope is that the vetoes considered in this thesis have the power to disturb a much larger part of the fabric of political life than the vetoes considered by Tsebelis, which only block a particular piece of legislation.

Extending the analysis from legislative passage to implementation reinforces the methodological challenge of identifying vetoes and veto players. While in the legislature it is clear whether a policy has been 'vetoed' (since voting is binary and usually a matter of record), during implementation policies can be blocked covertly and to different degrees. In Tsebelis' model all can agree on the identity of veto players and vetoes, since veto players are specified (in a constitution, for example), and vetoes are explicit and public. In contrast, in the Ecuadorian political context it is much less clear who is a veto player and when a veto has been used. Where Tsebelis can consider only subsets of 'formal' veto players (institutional and partisan), this thesis must also consider 'informal' veto players.

To cope with this methodological challenge, the requirements for 'veto' are specified in more detail in this thesis than in Tsebelis' work. Namely, psychology is important. For Tsebelis, there is never a conflict between what a veto player thinks has happened and what an agenda setter thinks has happened. In the real world, especially in a context with severely limited information, the two can easily perceive events differently. Tsebelis did not have to consider the role of perception in the definition of a veto player; in contrast, this thesis must specify whose perception counts. Ultimately, the perception of the agenda setter is the most important; after all, it is the agenda setter who takes the vetoed policy off the agenda once it is vetoed.[56]

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[56] This does not solve the methodological challenge, but rather shifts the question. How does one know that the agenda setter has believed there was a veto? I discuss specific details of how one might investigate this in the methodology section below.

Given these differences of context, scope and definition, the objection may be raised that this thesis uses Tsebelis' veto player model inappropriately—that it has taken his tool too far from its original purpose. A reader may have any of three specific concerns: firstly, that in departing from the original veto player model, the Ecuadorian analysis cannot test it, and perhaps, arising from this limitation, that this thesis does not contribute to the mass of existing veto player analyses; secondly, that the new theory introduces extra methodological challenges in terms of defining veto players and cannot look to Tsebelis for guidance; thirdly, that the new theory is unfalsifiable, because of the ambiguity surrounding the identification of veto players. This section shall address each of these in turn, arguing that while Tsebelis' approach does have the advantages of methodological purity and comparability with existing research, the approach used in this thesis is internally consistent, methodologically defensible, and particularly insightful in the Ecuadorian context.

The first concern surrounds the departure from standard veto player theory. Indeed, several factors have been changed at once in departing from Tsebelis' model, which precludes comparison with the original. If the point were to test Tsebelis' theory against a new context, then it perhaps might seem unfair to do so against a context which is so different. But on this point this thesis restricts itself to proposing that an account of veto players in Ecuadorian politics informed by insights from Tsebelis is useful in explaining a complex empirical case. On the other hand, the approach *does* allow for some revealing cross-country comparisons. This chapter argues that Ecuador suffers from a proliferation of veto players; by definition, this means Ecuador has many groups capable of bringing down the government. And in fact, since 1996 the government *has* been brought down three times, by three different groups. Ecuador's instability makes it easy to credibly threaten to bring down the government. In contrast, a *coup d'état* or successful popular uprising against an American president is virtually unthinkable, and thus the United States has few or no extra-constitutional veto players.[57]

The second concern is that departing from Tsebelis' approach introduces major methodological challenges. Indeed, it is easier for Tsebelis to identify a veto player, since his veto players' identities are clearly laid out in legislation or other written documents. Where Tsebelis examines discrete, separable events, this thesis

[57] This may seem a high bar, but after all, we are talking about a *veto*, the strongest possible form of influence.

must examine a raft of intersecting and inter-linked events and decisions. For this reason, the new 'veto players' test was developed (and outlined earlier). Like the old one, this new test may apply to different groups at different times and on different issues. But the key addition, the requirement of a credible threat, can be analysed fairly robustly by examining empirical evidence such as contemporary political analysis, insiders' personal recollections, and reports of protagonists' behaviour. In this vein this thesis considers at various points the power of the influencing/vetoing party, whether they had the capacity to veto (based on past events, and what we can glean of the psychology of the decision-maker and his/her beliefs); the veto player's motivations and orientations, chiefly in terms of their interests; and the veto player's actions, especially their attempts to communicate opposition to decision-makers, and the strength of that opposition.

The third potential concern was that the approach used in this thesis is unfalsifiable. With any theory, it is important to explain how the argument could be falsified if the data were different; if this cannot be done, the theory is bankrupt. In this thesis, it may appear that if the boundaries of what counts as a veto player are contestable, then perhaps the sets of 'veto player' and 'non-veto player' can be expanded and contracted to produce any result the theorist desires. If a group can be a veto player some times but not others, does this mean they can be counted as a 'veto player' *post hoc* when a bid to oppose is successful, and discarded from the analysis when the bid is unsuccessful? In fact it is not the case that veto players can be counted or discarded at will; while argument is possible at the margins, there is a solid core of definitional clarity. To observe this, consider three (fictional) scenarios in which the theory could be empirically proven invalid.

1. Imagine that a group which has exercised its veto on an issue later appears to lose its status as a veto player for no apparent reason. Following a veto, group leadership, membership, societal popularity, privileged relationships, financial strength (etc.) remain the same, but the group is inexplicably unable to veto a closely-related issue. For example, a Quito-based group of indigenous people are able to stop oil drilling in Amazonian Block A but not in neighbouring Block B six months later. If agenda setters have good reason to believe that the group remains a veto player but the veto still 'fails', this would show that vetoes or veto players do not function the way outlined in this thesis.

2. Imagine that there is convincing evidence (diary entries, friends' testimony, public speeches) showing that a leader believed he would fall by opposing a particular group on a particular issue. However, this leader enacted the policy in question regardless. Then, when he did fall, the policy endured. In this case the group demonstrates all the trappings of a veto player, but lacks policy effect. The veto player test and methodology as outlined in this chapter would manifestly fail to predict policy failure.

3. Falsification of my arguments on a smaller scale is also possible. For every identification of a veto player, there could exist an empirical counterargument. For example, I might argue Leader X considered Group Y a veto player, based on what Leader X told me in an interview and (say) because of Group Y's stranglehold on the provinces. In response, a well-informed reader could point out that Leader X was quoted saying something quite different at the time in a local newspaper, and that Group Y's hold on the provinces appeared to be loosening at that time; perhaps Leader Y was rationalising in light of later events, and the true explanation requires more digging. I must establish vetoes empirically every time. One of the major challenges of this thesis will therefore be to identify the *right* veto players, based on a very careful appraisal of the Ecuadorian political system.

The discussion so far has focussed on addressing concerns internal to the theory: methodology, consistency, falsifiability. However, a more fundamental question is why anyone should develop a new veto player theory at all, however consistent and empirically defensible. Why go to all the trouble? To answer this, I shall outline the new model's two main relative strengths, one distinguishing it from Tsebelis' approach, and the other distinguishing it from approaches which do not use the veto player concept at all.

A key strength of the approach used in this thesis vis-à-vis Tsebelis' is its heuristic value, rather than a narrow formal model. Earlier, I outlined the decision to consider implementation rather than just the passage of legislation, and the methodological challenges it introduces. This thesis examines implementation because to consider only the passage of legislation in Ecuador would be to ignore the real workings of political power. The game played out in the Ecuadorian Congress is but a tiny piece of a vast network of actions and reactions; not the highest expression of political power but a sometimes-marginalised collective actor, with often far less influence on events than actors whose existence is not always visible to the naked eye.

Additionally, the implicit assumption that legislation is the end of the matter would be particularly naïve in Ecuador, where so much legislation is never implemented in reality. Considering only the passage of legislation would fail to answer the question of why IMF reforms were agreed to but not implemented—often the reforms required no legislation, and often the legislation was passed but had no effect. This thesis therefore considers not only the small slice of politics that is the formal legislative process, but also the messiness of contextual politics.

Given this, the approach is likely to be of use in other political contexts which share these qualities. Examining the Ecuadorian policy-making process in this way may help others probe and understand aspects of causality within such contexts. Of course, there is a place for formal models powered only by selected key drivers, but these must be periodically compared to messy reality. There seems limited value in a theoretical framework whose assumptions will never hold true in a real-world political context. Namely, legislative decisions are often related to each other. Factions within a legislature are continually jockeying for position and tradeoffs are continually made. As a consequence of this, either one argues that Tsebelis can never be applied to real political life (in which case what is the point of his developing, or our paying attention to, his model?)—or one accepts that there are some real-world contexts to which a veto player model, appropriately adjusted and specified, can be applied.

The approach is also dynamic, accounting for change as well as stasis. This is because it allows for the creation and removal of veto players depending on relative perceived power, which in turn depends on instability. This explains things like the ability to reform during a president's 'honeymoon' period (the third insight from the interest group literature).

It is also important to consider why the thesis incorporates a veto lens at all. A reader might ask whether a more familiar term such as 'influence' could be substituted for 'veto'. The answer is that while this thesis *could* be re-written in terms of 'influence', 'veto' is a more precise concept—and this precision makes it an illuminating tool within the political context under investigation.

Let us first demonstrate the precision associated with the 'veto' concept, then its usefulness. 'Veto' forms a particular subset of influence which can be explained by reference to an example. Imagine that various levels of support for a Policy X can be represented by a spectrum from 0 to 100%, and that Policy X will be implemented if it achieves more than 50% support. Three scenarios illustrate the relationship of

'influence' to 'veto'. Imagine firstly that an influential actor has the power to increase support for Policy X from 10% to 40%. Since Policy X still has less than 50% support, it will not be implemented. The 'influence' of the actor may be an interesting aspect of the story of Policy X, but it has had no clear effect on its implementation in the short term. In the second scenario, the actor decreases the level of support from 40% to 10%. Again, this has no clear effect on implementation. Policy X fails despite the actor's influence and thus the actor is not a veto player. Now, imagine that influence decreases support from 60% to 40%. This would affect implementation, as it lowers support below the crucial 50% mark. The actor is a veto player because this is sufficient to cause Policy X to fail. Furthermore, inherent in the concept of a veto is the idea of stopping something on the agenda from coming to fruition, a test which the third scenario also passes.

This is not to deny the worth of considering influence at all, but to emphasise that influence does not always determine the outcome. In the illustration, in purely quantitative terms the 'influence' was least in the third case; that is, the variance was 30% in the first two cases and 20% in the last. Despite this, because of contextual factors (namely, the threshold for implementation and the configuration of support) the third actor is a veto player and the first two are not. This situation is the subset of 'influence' which is so important in the Ecuadorian context that we assign a particular name to it, 'veto'.

The precision of the 'veto' concept enables it to be more illuminating. We are not aiming to explain why support for policies ebbs and flows in Ecuador in general terms, but to focus on why support drops below the threshold for implementation. To continue the analogy above, this thesis is not interested in the cases in which support moves from 10% to 40% and back again, but in those in which it drops from 60% to 40%.[58] Why are IMF policies put on the agenda, then not implemented? Using the veto concept we argue that *but for* the veto player's existence and action, the policy would have passed. The outcome is determined by a veto; 'influence', on the other hand, may have no ultimate effect.

To summarise the discussion: the analytical framework of this thesis is inspired in part by insights gleaned from the veto player analysis theorised by Tsebelis.

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[58] Lest the reader become distracted by the analogy, let me point out that not every threshold is 50%, that not every policy choice is linear, that whether a given influence event is also a veto may depend on existing configurations (in line with the earlier discussion of 'partisan' veto players), and that earlier events can influence later ones in unpredictable ways. The analogy is illustrative.

The thesis does not aim to test Tsebelis' theory, but rather to build on aspects of it. The approach used frames the process and dynamics of Ecuadorian politics in a comprehensive and dynamic way, permitting a more focussed and precise analysis than a study of influence more broadly writ. Finally, an important concession: it is hard to identify veto players, and there are likely to be more arguments around their identity than in Tsebelis' model.

In terms of the literature more broadly, this approach makes two theoretical contributions. Firstly, I bring together two strands of literature and apply them to a new case, testing their limits. Both strands of the political economy of reform literature offer a multi-part hypothesis for reform non-completion. Interest group literature suggests that societal vested interests, perhaps veto players, block reform. Institutional accounts suggest that reform is hindered by a weak, fragmented, clientelist state. The two strands are complementary, not contradictory. The most persuasive accounts bring them together, accounting for the fact of reform and also for its shape and content, by carefully considering 'discovered' preferences as well as 'derived' preferences. Manzetti (1993) for example, brings together theory regarding elites, society, institutions, parties, and accounts for ideology, derived interests, cognitive and strategic dimensions, and economic context. Manzetti's approach has the disadvantage of being less parsimonious than most of the rest of the literature, but leaves fewer explanatory gaps. Like Manzetti, I do not treat power or interest as black boxes, but explore preferences for elites, veto players and interest groups. In Ecuador, some reform was undermined by the very groups which would materially benefit; such standpoints are only explicable in terms of preference formation. Discovering these preferences and identifying actors and their influence necessitates using tools from various disciplines: an historical analysis of institutional path dependence; a sociological approach to discovered preferences; from economics, the elements of rational choice and the basis for the bargaining model; and the political economic base of theory on which the thesis rests.

The second theoretical contribution is more significant. This new theory of veto players integrates the institutional and interest group literature rather than just adding them together. Some accounts emphasise instability as an impediment to reform; others emphasise veto players as impediments to reform. I connect the two by considering how veto players are connected to instability, arguing that the variables identified in the institutional literature impede reform by providing an unstable

environment in which veto players can proliferate. Executive or state 'incapacity', for example, which is suggested in the institutional literature as an impediment to reform, is considered in terms of executives' capacity to respond to veto players as well as more broadly (what some others call 'good governance'). I consider how and when societal groups block reform through institutions, how their differential ability to do so accounts for variance in veto power, and how institutions affect interest group power.

At the heart of this is an argument that veto power arises from institutional structure. Veto players are the 'missing link' integrating interest group theory with institutional theory. The impact of chronic instability in Ecuador is not confined to, say, a change in government disrupting a five-year plan, but has a much more profound influence by means of veto player creation. Thus, perhaps paradoxically, instability is the key to stasis. This theory is parsimonious, as it explains non-completion in a crisis setting while not conflicting with the original veto player analysis which explained non-completion in normal situations. It also accounts for dynamism within stasis, as veto players discover their veto.

Finally, let us consider the limits of this approach's capacity to integrate existing literature. This chapter began by introducing a theoretical puzzle wherein two literatures ('bargaining' and 'crisis') led us to expect reform where none had occurred. We might now ask whether this new theory of veto players is reconcilable with either. Regarding the crisis literature, the answer is 'no'. This new theory is not easily resolved with the predictions of the crisis literature, since if crisis increases instability and this instability can create or maintain veto players, then crisis can be a force *blocking* (not catalysing) reform. If I am right that chronic instability is a major contributor to the number of players with veto power (that is, that a credible threat relies on the likelihood of the government falling), and if we assume for the purposes of this argument that crisis contributes to the instability within a system, at least in the short term, then this would seem to be evidence against the crisis-reform hypothesis. Whereas the crisis hypothesis predicts that crisis can catalyse reform, I tie stasis to veto players and veto players to instability, suggesting that crisis, especially political crisis, in the long run produces veto players and increases policy stasis. This would be

significant in terms of the literature because the crisis-reform hypothesis is ubiquitous; for example, in reviewing the literature, Corrales called it "almost indisputable".[59]

In contrast, this new theory of veto players need not conflict with the bargaining literature. This is because the bargaining model focuses on negotiation rather than implementation, and veto players need not influence this stage. Negotiators could be autonomous, making agreements divorced from the realities of implementation.[60] If agenda setters are unaware of the identity or preferences of veto players, or if they become veto players only after an agreement is negotiated, they may negotiate agreements doomed to non-completion. In reality, negotiators have limited knowledge and computational capacity and must act on the basis of 'bounded rationality', 'satisficing' rather than maximising.[61] Only when domestic constituencies have a means of discovering the content of negotiations and communicating their opposition will technocrats perceive this as a constraint. If technocrats are autonomous, even if negotiations do not produce an outcome within the domestic winset, negotiators can agree anyway, increasing the risk of programme non-completion.

In 2003, Bird and Rowlands outlined a multi-year research agenda: "to move forward from recognising that political economy variables are important, towards a better understanding of precisely what the political economy variables are, and the modalities through which they exert their influence".[62] This thesis forms part of the body of work filling these gaps.

Other concepts and definitions

This thesis employs a terminology of 'success' and 'failure' in economic reform which should be carefully defined. 'Success', in reforms, could mean any or all of three elements: a reform is implemented (a state utility is sold), a reform

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[59] Corrales (1997:617), and see also Rodrik (1996:26): "If there is one single theme that runs through the length of the political economy literature it is the idea that crisis is the instigator of reform". Tommasi and Velasco, too, call "the notion that economic crises seem either to facilitate or outright cause economic reforms" part of "a new conventional wisdom" (1996:197). See also Corrales: "numerous scholars remain convinced" that economic crises are "a necessary precondition" for the political consolidation of stabilisation and structural adjustments (1997:620).

[60] The literature on democratic consolidation and economic reform highlights the importance of technocratic autonomy. Bräutigam emphasises the "empowerment of technocrats and insulated decision-making", including avoiding the legislature but points out that this undermines democracy and, with Stark and Bruzst (1998), that it is not necessarily sustainable (1997:47). But as Allina-Pisano (2004) found in post-communist societies, autonomy cuts both ways. Decision-makers at a local level can be ideologically opposed to reform and block it or undermine it.

[61] Odell (2000:10).

[62] Bird and Rowlands (2003:1275).

endures (the utility remains in private ownership) or a reform achieves its stated aim (service provision becomes more efficient and effective, and state finances benefit from no longer subsidising a loss-making enterprise).[63] The same, in reverse, applies to 'failure'.

This thesis initially focuses on the first element of 'success', implementation. I discuss seven 'failed' reforms which were never implemented and thus never had a chance to either endure or achieve their aims. I then discuss four reforms which *were* implemented, enabling consideration of the second and third elements of success (endurance and achieving stated aims). Of course, endurance is open-ended, but I consider 'successful' the reforms which endured until May 2005, the month after the period considered in this thesis. Similarly, success on 'stated aims' can be hard to grade as reformers' aims may differ, may not be reflected by public statements, and may be partially achieved. This thesis will glean 'stated aims' from public statements by the institutional reformers during implementation. Using these definitions, Chapter Four will show that each of the four implemented reforms either did not endure, or did not achieve its stated aim.

A caveat: this thesis does not aim to evaluate the content of reforms or make policy recommendations as to what kinds of reform are desirable. Throughout, the shorthand 'success' is intended empirically rather than normatively. Some of the reforms considered have almost universal support (making customs less corrupt, for example) but others are highly contentious. I do not intend to take sides in this debate, but instead to explain how the defeat of each reform can shed light on the way political power works in Ecuador.

It is also important to consider what we mean by 'crisis'. Some versions of the crisis-reform hypothesis, as Rodrik points out, are "virtually unfalsifiable: if an economy in crisis has not yet reformed, the frequently proffered explanation is that the crisis has not yet become 'severe enough'".[64] This is due in large part to the difficulty of defining 'crisis'.[65] How can we deal with 'enduring crises' or the 'permanent' state of crisis that some Latin American countries perceive themselves to

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[63] IMF agreements might appear to provide a good test, but are not as objective as they appear; agreements typically contain several quasi-conditions never expressed in formal sections and are subject to political waivers.

[64] Rodrik (1996:27).

[65] As Hay says, it is "one of the most illusive, imprecise and generally unspecified concepts within the theoretician's armoury" (1999:318).

be in? If crisis is a departure from the norm, what happens when crisis becomes the norm? There seems no useful difference between a country in 'permanent crisis' and one which is simply poor. Perhaps because of this conceptual problem, the concept of 'the bottom' of the crisis has emerged.[66] But this does not solve the problems of identification or falsifiability.[67] The 'bottom' of a permanent crisis does not seem very different to 'a crisis in a country which is already poor'. However, the fact that it has appeared in the literature reinforces the point that the variable involves some kind of departure from the norm. In order to have any explanatory use, then, a crisis needs to be something new. Because there is a significant psychological component to crises, a crisis needs to somehow involve a departure from expectations, which for a nation will be formed by past country performance, and involve a strong psychological aspect of national identity.

Some, like Ferreira et al., attempt an objective definition of crisis: a macroeconomic crisis is "any episode characterised by either (a) a decline in gross national product (GNP) over the 12-month period from the onset of the crisis; or (b) a doubling in the country's monthly rate of inflation to above 40% per annum at any point within that 12-month period; or (c) both".[68] Others, like Tommasi, attempt subjective or psychological definitions: crises are a "mental state" related to "country-specific aspiration levels".[69] The crisis in this study, Ecuador's in 1999, meets both Ferreira's criteria and Tommasi's: a decline in GNP over a 12-month period and a state domestically and internationally perceived as a crisis.

The literature does not dwell much on what counts as 'reform'; the crisis-reform literature, for example, makes little comment about *which* reforms crises will attract support for, merely that they will depart from the status quo. Most of the empirical political economy of reform literature considers neoliberal reforms, probably because cases are so numerous. This study similarly focuses on typical IMF structural adjustment reforms: fiscal policy reform, reducing the rate of growth in government spending, reforming the tax structure, phasing out government subsidies,

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[66] Corrales, for example, argues that if a country does not hit bottom, it lacks the conditions for reforms (1997:626-7).

[67] Some of the literature robs the concept of explanatory power by defining the 'bottom' in terms of its outcome. For example: "After society touches 'bottom', draconian measures to control inflation and neoliberal restructuring efforts no longer confront powerful blocking coalitions" (O'Donnell 1994:175). As Corrales notes, this rather deflates the crisis parameter as an explanatory aid.

[68] Ferreira et al (1999:2).

[69] Tommasi (2003:8)

and privatisation. [70] I consider seven reforms in Ecuador: customs, oil, telecommunications, electricity, tax, LPG subsidy and civil service (and discuss the basis of selection in the next section). Corbo calls these reforms 'first generation', as opposed to 'second generation' reforms such as public sector, judicial, regulatory, decentralisation, education and health reform.[71] This does not mean they are simple; unlike "stroke of the pen" stabilisation policy like interest rate/exchange rate changes, these adjustment policies cannot be implemented autonomously by the central economic authority (or, often, any central authority).[72]

Finally, a note on the selection of my time period. My work focuses on January 2000 until April 2005 for two reasons. Firstly, this period offers fruitful contrasts between administrations. The period covers the terms of two presidents, Gustavo Noboa (2000-2002) and Lucio Gutiérrez (2003-2005), each of which had an IMF agreement (2000 and 2003). The two administrations had important differences: one was elected, one interim; each had different levels of commitment to different reforms; and each president had multiple economic teams whose philosophies and strategies differed. The period also covers the tenure of three IMF mission chiefs. Moreover, during this period Ecuador emerged from a devastating economic crisis and, particularly in 2004-2005, began to benefit from high oil prices. Ecuador's dependence on the multilateral lending institutions thus varied enormously during these five years and offers another natural basis for comparison. Meanwhile, by focussing on a short period, several important slower-changing variables can be kept reasonably constant: the global donor situation, aspects of Ecuadorian political culture, the Ecuadorian electoral system (to which major changes were made in 1998), Ecuador's role in the Andean community and the Americas (especially regarding Colombia), and even the participation of many individuals in national politics. Starting in early January 2000 also allows coverage of the whole post-dollarisation period, important because dollarisation affected institutions' relationships with each other and the IMF. Secondly, starting after the peak of the crisis avoids the highly unstable years from 1996-2000, when two presidents were ousted, 17 banks failed and the currency collapsed. It is less surprising that non-urgent structural reforms were

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[70] All of which appear on Biersteker's list of common components of SAPs and also meet his broader definition: "In the most general terms, structural adjustment entails a reduction and redirection of state economic intervention in the economy in combination with an increased reliance on the market for the allocation of scarce resources and commodities" (Biersteker 1993:5).

[71] Corbo (2000:75, 83).

[72] On this, see Bräutigam (1997).

postponed in this tumultuous period. I focus instead on the reforms postponed during later years of relative stability and prosperity, when failure is harder to account for.

Methodology

The investigation within this thesis can be broken down into a number of tasks which shape subsequent chapters. The first is to explain how the reform agenda arose. Why was reform even attempted, and did something about the process of agenda-setting set the reforms up for failure? This question is answered in Chapter Two, in a detailed examination of the negotiating teams and their incentives and motivations. The second task is to account for the reforms' failure. This begins with an immediate explanation, the heart of which is an analysis of seven reform attempts arising from the 2000 and 2003 agreements (Chapter Three). I intended to investigate the most significant reforms attempted under the IMF agreement. These were the reforms which were most salient to those who knew the economy intimately, and rated by them as the most important. They were not always the reforms on which most time and effort had been spent, since policymakers had sometimes been blocked from expending effort, and this was incomparable in any case as the body charged with implementation varied from reform to reform. Nor were they necessarily the reforms with the most economic impact, since this was difficult to quantify in advance and, of course, the reforms were never actually implemented. Instead, I attempted to capture 'significance' by consulting policymakers and analysts who had a good overall perspective of the IMF negotiation and the Ecuadorian economy. In particular, I asked seven Ministers and Vice-Ministers of Economy and Finance what their reform priorities had been. As a check against selective memory, I asked the same question of other interviewees including IMF, Central Bank and other MEF officials, economic commentators, Ecuadorian academics and politicians. The opinion of interviewees who specialised in a particular area (Energy, for example) was given less weight in the selection of reform cases, as they lacked the crucial overall perspective. As a result of this consultation, an original list of five reforms, prepared before fieldwork on the basis of available documents, was expanded to seven. Each of these reforms was intended to help fulfil the main aims of the IMF programme, strengthening public finances and saving resources to enable debt buybacks.

Considering individual cases of reform exposes the evolution of the reform agenda over the five-year period, and, by narrowing the scope, allows us to see the complexity of reform and to examine properly the motivations and incentives of the numerous individuals and groups involved. The cases are 'areas' rather than individual 'reforms', since several evolved during the period ('tax reform', for example, meant VAT in 2000 and earmarking in 2003). As a check on this analysis of 'failure', I then account for 'success', examining four reforms named by interviewees as the most successful in recent Ecuadorian history. These reforms did not arise from IMF conditionality (although the IMF was involved in some of them); the goal is to check that factors I identify as contributing to the failure of IMF reforms were not also present for these successful reforms. This analysis occupies Chapter Four, where we see that ultimately even 'successful' reforms are undermined.

A key part of the theoretical framework presented above was the idea that crisis could further increase the factors that the institutional literature found impeded reform (in particular, state incapacity, fragmentation, polarisation, clientelism). To test this, this thesis needs to first consider whether these factors do impede reform in Ecuador, and then consider the effect of crisis or instability on them. The final four chapters divide this work between them, finding evidence consistent with this set of propositions.

Chapter Three and Chapter Four together provide a mass of evidence that failed implementation of reforms in Ecuador was attributable to any one of three factors: *societal veto players*, *legislative opposition*, and *executive incapacity*. The first two factors are a useful way of dividing up the concept of veto players for empirical analysis, focussing on veto players which operate legislatively and extra-legislatively. The third confirms a hypothesis which arose from the institutional literature, that executive or state incapacity is a significant cause of reform failure. Having established these factors empirically in Chapters Three and Four, I then consider their origins and significance in Chapters Five and Six. This fulfils the final task, to move from immediate explanations of reform failure to a deeper explanation of why the conditions creating failure arose and persist in Ecuador. From where do veto players draw their power, and why are there so many? Why have executives lacked capacity to deal with these challenges? These questions are answered in Chapters Five and Six respectively. Both chapters aim to endogenise the key explanatory factors, explaining how Ecuador's poor political equilibrium arose.

To complete these tasks, my thesis draws on five sources of empirical data.[73] Each has strengths and weaknesses. I 'triangulated' iteratively, using multiple methods of enquiry to cross-check data and contextualise sources. Hidrobo calls this the Latin American tradition of empirical, holistic, nuanced methodological eclecticism;[74] such research admits that there is an inevitable element of interpretation in its findings but attempts to minimise one's own bias.

The first set of source material is official governmental and inter-governmental documentation, including IMF and World Bank reports and publications by Ecuadorian state institutions. In Quito, I conducted research in the libraries of Congress and the Central Bank, and the FLACSO and CORDES research institutes. In Guayaquil, I used archives in the University of Guayaquil and Oxfam Ecuador. Some documents were also obtained from interviews, and many were online. These official documents can provide authoritative, accurate information, but are often poorly contextualised and reveal little about the political factors which may be more significant. In particular, analysing IMF documents involves tricky methodological issues.[75] It is somewhat arbitrary whether 'supplementary' Letters of Intent should be counted as part of the original reform agenda, but important for country cases such as this which distinguish 'agenda' from 'implementation' (and can be crucial in cross-country or longitudinal comparative studies of IMF agreements). In this thesis, I consider supplements on the same basis as the original Letter of Intent. Then, as Kapur says, all IMF conditions are not equal. Documents alone do not reveal which conditions or reforms the IMF thought most important. Some indication may be gleaned from public statements, or from the IMF decisions to release or suspend funds, but public IMF statements rarely offer detailed criticism, and multiple factors can motivate suspension or continuation. Interviews with officials are invaluable here, although as with all interviews their value can be limited by officials' ability to

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[73] Regulations require me to declare that although the bulk of this research was carried out for my DPhil, I draw on some of the fieldwork I undertook for my MPhil thesis as well. That thesis concerned dollarisation in Ecuador, a different issue in a slightly earlier period. I have reinterpreted much of the earlier research, especially since that work did not discuss 'veto players', the concept at the heart of this thesis.

[74] Hidrobo (1992).

[75] Other important methodological issues are usefully discussed in Kapur (2000). Namely: which documents count; how to weigh conditions, as since all are clearly not equal; how to deal with the 'strategies and measures' of the preamble to the tables and lists which constitute the official tranche-releasing conditions; how to count conditions, for example when comparing agreements.

accurately recall motivations or conversations from several years ago and their desire to reveal that information.

To supplement official documents I turned to my second source: 'grey literature' such as minutes of meetings, NGO publications, flyers, and so on. These tend to be highly biased, but the bias itself offers insight into players' worldview, arguments and perceptions of events. I obtained these documents from interviewees and institutions, and also at a number of political meetings and rallies I attended as an observer.

Thirdly, I used Ecuadorian newspapers extensively, working from a variety of archives and reading several thousand newspaper articles. These have the advantage of being generally factually reliable, especially when several newspapers cover the same event. Moreover, newspapers reveal the conventional wisdom of how events and processes are politically contextualised, often providing analyses which can be fruitfully discussed and problematised with interviewees. Newspapers may be politically biased, of course, but not usually to the same extent as 'grey literature' or interviews.[76]

Fourth, I used secondary sources for background. There is only a little good recent political economic work on Ecuador in either English or Spanish. Nevertheless, good scholarship exists examining the military era and pre-crisis politics and development, and there are some excellent economic and social histories. As a partial fix for the lack of relevant formal published work, I met with many academics in Ecuador and discussed aspects of Ecuadorian political economy.

Finally, and most importantly, I conducted 103 face-to-face interviews with witnesses and informants over two years. These took place in five rounds: in Quito, Ecuador (2003); Guayaquil, Ecuador (2003); Quito (2005); San José, Costa Rica (2005); and Washington, USA (2005).[77] As well as being a source of grey literature and other documents, these interviews provided invaluable data unavailable elsewhere. Through interviews, I also aimed to investigate undocumented meetings and other events, and examine relationships between players.

Interviewees were selected in two stages. Before arriving in Ecuador, I read approximately 3000 newspaper articles since 1995, and constructed a 'wish-list' of 70

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[76] Although ownership of Ecuadorian media is highly concentrated, newspapers are remarkably free to criticise the government and ruling elite, and generally reflect less overt commercial or political bias than the Ecuadorian television media.

[77] I conducted 35 interviews in 2003 and 68 in 2005.

relevant prominent political individuals. Once in Ecuador, I supplemented this list by 'snowballing', a non-probability sampling technique based on personal networks.[78] The newspaper search was intended to partially counter a danger I became aware of during a pilot trip in 2003, when I found myself 'snowballing' within one societal level and missing networks entirely.

Interviewees fell into two groups (with some overlap): witnesses who could give first-hand accounts of events or relationships not documented elsewhere, and informants who could reflect more generally on players' motivations and the connection to underlying political culture. Interviewees included two presidents, three vice-presidents, thirteen ministers and four vice-ministers (seven Ministers of Economy and Finance, six of Energy, and the rest of Trade, Planning, Public Works, and Government), two unsuccessful presidential candidates, seven IMF officials, including all mission chiefs over the period 2000-2005, five World Bank officials, 13 central bankers (most either general managers or on the Board of Directors), 11 representatives of unions, indigenous and environmental organisations and other civil society groups, nine university academics, several heads of state institutions (Inland Revenue, Andinatel, Solidarity Fund, Petroecuador), the Ecuador desk officers covering the period 2000-2005 at the US Treasury and the State Department, four representatives of embassies in Quito, five journalists, four members of Congress, and nine representatives of private businesses or chambers of commerce. A full list appears in Appendix B. Interviews lasted between 30 minutes and three hours, with most lasting about an hour, and were conducted in Spanish or English, according to the interviewee's preference.

In the initial stages of fieldwork, I used semi-structured interviews with open and semi-open questions, allowing the interviewee to indicate their areas of expertise and experience. Although personal accounts can be factually unreliable—especially regarding dates, figures and chronologies—and are strongly biased, they give invaluable insight into the way players perceive events, their and others' motivations, and the priority given to various factors in decision-making. Of course, a researcher must be aware of the influence of hindsight over interviewees' recollections of causes, effects, relationships and motivations. Facts were cross-

[78] See May (1997:119).

checked in other interviews and, where possible, against contemporary documentary sources. Often what was remembered and what forgotten was itself revealing.

In later stages I used informants to evaluate and react to my hypotheses and data. As Srinivas writes, "it is best that a culture is studied by both insiders and outsiders. Alone, neither is complete".[79] I was aware that presenting hypotheses to interviewees could have 'led' them, but the danger of this seemed slim in practice. By 2005 I was meeting almost exclusively with high officials, academics and businesspeople. These interviewees had achieved academic success, were highly respected in their fields, and were usually specialists in the subject under discussion. All engaged in fruitful debate over the validity of my findings. I particularly used the Washington round of interviews, the final stage of my fieldwork, to check that the theories I had developed from interviewing Ecuadorians were consistent with the experience of foreign IFI officials. In fact, the version I had distilled was remarkably similar to these officials'.

By a stroke of good fortune, the round of 56 interviews I conducted in April 2005 ended just days before the fall of Gutiérrez and marks the end of the period under consideration. The combination of archival and statistical material covering the early 2000s, newspaper articles from 2000-5, and the interviews in 2003 and 2005 therefore provide a comprehensive picture of events throughout the five-year period.

Limitations of this research

As with all research, there are gaps due to constraints of time, space and resources. A comparative perspective, perhaps with another Latin American case, would have yielded interesting insights but required the sacrifice of much of the depth and detail I was able to attain by focussing on one country. Instead, I aimed to interview all individuals which appear in this thesis, and representatives of all groups and institutions. However, it is always possible to interview more people. I did not interview a large enough sample from any one institution for responses to be statistically significant. This was for two reasons: firstly, my analysis required a history rather than a survey, and secondly, usually only a small number of representative individuals were familiar with what I wished to discuss. When insights began to diminish significantly this indicated an institution had been sufficiently

[79] Srinivas (1997:22).

covered. But although my sample has good representation on either side of most of the major political cleavages, certain groups are underrepresented. It was easier to access retired than current politicians, so there is good representation from the 1990s and some from 2000-2, but less from 2003-2005. Several key players have been exiled, for reasons given in this thesis, and live in Panama, the Dominican Republic, Miami, Boston or Washington; others are imprisoned in Ecuador. One exile, former Vice-President Alberto Dahik, was sufficiently important for me to travel to Costa Rica to interview, and several were accessible in Washington. Had time and funds permitted, I should have liked to have interviewed more of these exiles.

A further set of key players was unreachable for reasons of safety. My research often strayed into the territory of covert activity, and I had to avoid giving the impression of intending to expose organised crime. A frank examination of business connections to the drug trade, of which I heard only rumours, was a casualty of this. Some central players would never acknowledge their participation in the events under investigation, and alternative sources had to be used. There was also a constant risk of being fed purposely misleading allegations or data. This risk is impossible to eradicate, but I tried to minimise it by taking a cautiously sceptical approach and constantly cross-checking with, in order of preference, verifiable documentary sources, relatively neutral informed parties, political opponents, and the actors in question. Where there remains significant doubt, I have excluded the material. In most cases these omissions (which were frequent) are not significant to the analysis—for example, where two opposed factions agree that a certain practice occurs, but claim different individuals are involved, then agreement nonetheless exists at the systemic level.

My fieldwork focussed on Quito and Guayaquil, particularly Quito. As well as research there, I travelled to Baños, Mindo and Huaquillas. However, for reasons of time, cost and (near the Colombian border) safety, it was unfortunately not possible to cover all of Ecuador. For example, I did not travel to the Amazon, instead relying on interviews with representatives of rural or Amazonian organisations in the major cities. This is a 'gap' as Quito-based leaders of indigenous groups are, by virtue of their position, indubitably differentiated from their rural counterparts. On the other hand, the focus of my research was on the perceptions and actions of key political players, and these are mostly located in Quito. Even when major players live outside Quito—indigenous protestors, for example—they manifest opposition by marching and

demonstrating in the capital. I sought out political representatives of other provinces—my sample does include several coastal politicians—and recognised the gap in my reading and interview questions.

A further set of gaps remains unidentified. There may be important cases or political cleavages which my interviewees did not emphasise and of which, as an outsider, I was ignorant. For example, this thesis discounts religion as a political cleavage; this is based on the fact that no interviewee mentioned it at any stage, except for one instance of a president appointing members of his church. These potential gaps arise from my status as an 'outsider'. In contrast, familiarity with one's own society can help a field researcher achieve insight, develop hypotheses and establish rapport.[80] Maruyama says, "Inculture persons are full of hypotheses of their own. These are inculture-relevant hypotheses, and are often of the sort that cannot be dreamed up by outsiders".[81] Nettl writes that the insider provides the culture's own perspective whereas the outsider's view is essentially comparative and "merely adds something less significant".[82] This is not to say that the insider always has the advantage. Insiders and outsiders alike encounter the world with our own "interpretive presuppositions" or "forestructures".[83] Insider perspective can dull the researcher's sensitivity, and make it hard to maintain objectivity.[84] Perhaps most importantly, my status outside the Ecuadorian political, personal and familial networks made me a neutral figure able to access other networks and strata, and lacking personal ties to Ecuador means I do not suffer conflicts of interest.

Two important issues were researched but excluded for reasons of space. Firstly, this thesis ignores the role of the USA in Ecuador during the period. While in Ecuador I found some evidence that the US State Department, working with the US Treasury, had influenced the IMF's treatment of Ecuador on various occasions, principally because of the strategic importance of Ecuador in Plan Colombia. However, during later fieldwork in Washington it became clear that this link was somewhat exaggerated (although not non-existent). The issue is interesting but not ultimately central to my argument, and thus I have left it out. The second issue is the role of foreign capital in Ecuador. There are multiple instances of foreign business

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[80] On this, see Kim (1990:197).
[81] Maruyama (1967:234).
[82] Nettl (1983:262).
[83] Madison (1990:51), Heidegger (1962:195).
[84] Morse (1994:27), Kim (1990:197).

entrants being rejected when Ecuadorian political-business alliances were able to mobilise the banking, judicial and political systems to expel them. Of these, I discuss only barriers to foreign capital in the oil industry, as they relate to a specific reform case study.

The scope of this thesis precludes an in-depth examination of the internal procedures, constraints and incentives within the IMF. Accounts of how the standard IMF line has been developed can be found elsewhere; I take the neoliberal project as a given. This partially reflects a methodological constraint (the IMF is notoriously guarded), but more importantly reflects my focus on Ecuadorian reaction to a given agenda and how a shared agenda was created. Where departures from typical IMF practice or agenda are significant, I discuss and account for them. Similarly, it is outside the scope of this thesis to give a detailed historical account of the rise and fall of various movements and veto players. Of course, contemporary political economy must not be ignorant of its historical context, and some background is necessary to understand players' motivations, but the emphasis throughout is on how the system functions during the period under examination.

Finally, I should note that several interviewees agreed to be interviewed only 'off the record'. Others were happy to have their names used for some issues, but not others. Attribution of information in the footnotes is at times deliberately opaque out of respect for these requests for confidentiality.

Chapter Two: A Reform Agenda Emerges (1999-2005)

Chapter One revealed the end of the story: veto players successfully opposed reform. This chapter starts at the beginning of the story, outlining what they were up against. It examines how the reform agenda was generated in the Ecuador-IMF negotiations from 1999-2005. I focus on the domestic coalition for reform—their identity, powers, constraints and motivations—and the relationship with the IMF team and its agenda. Once we know why agreements were reached, by whom, and what their powers are, we can better understand how opposition overcame the reforms. We therefore put veto players to one side for the moment, bringing them back in Chapter Three. In this chapter I examine a period in which negotiations waxed and waned—and the IMF relationship ranged from harmonious, tight agreement to complete breakdown—to reveal the reform coalition's fractures, strengths and limitations. There are two overall questions: why did negotiators agree to reform in the first place, and did something about the process of agenda-setting set the reforms up for failure? This chapter examines a potential answer: that crisis might catalyse agreement to an IMF reform agenda, but not reform itself.

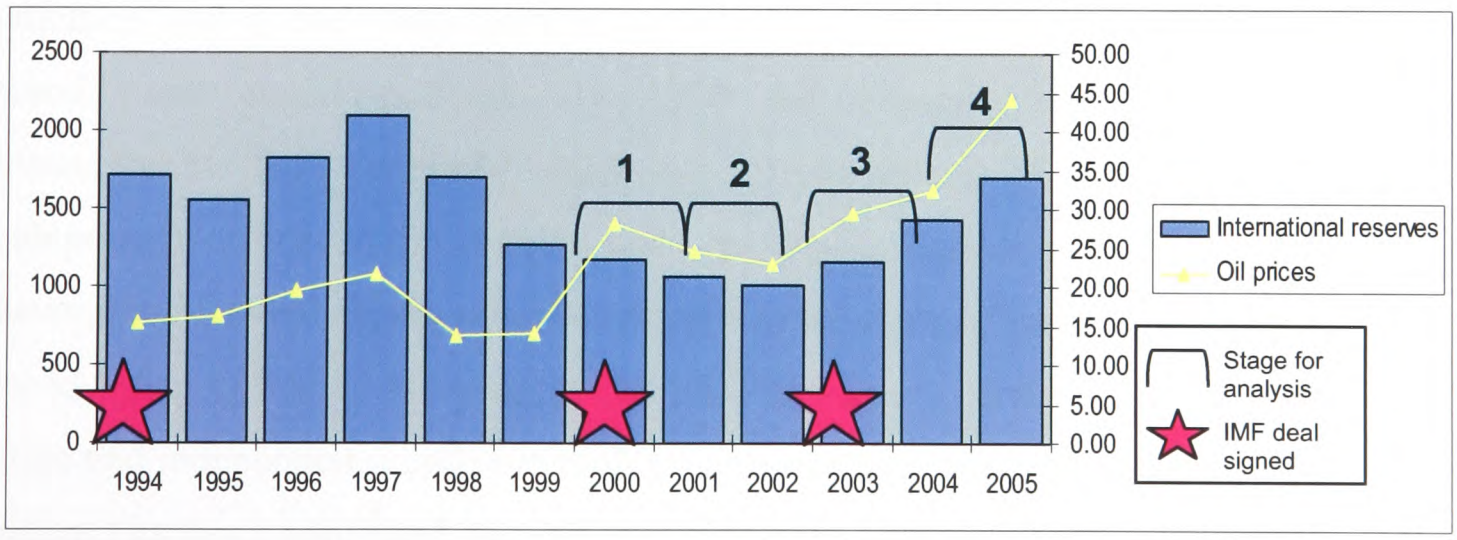
To do this, I consider IMF agreements in 2000 and 2003. I find that 'weakness' following crisis drove the first IMF agreement. Since we know this agreement was not implemented, I then ask whether its origins in crisis contributed to this. Is Haggard correct that technocratic autonomy increases during crisis and thus more radical reform will be agreed, and does this make implementation less likely? Considering the second IMF agreement, the story gets more interesting as we see that weakness does not always produce agreement, and also that agreement is not always a function of weakness. In other words, crisis is neither a sufficient nor a necessary catalyst of an IMF reform agenda.

Since 'crisis'/'weakness' is an insufficient explanation, I look for a better one by examining the negotiations in depth. First, I establish who the reform coalition was and how its membership varied. How suited was the reform coalition to implementing reforms? I find that the coalition for reform centres on the MEF and that other institutions' involvement is small. I also examine the degree to which agenda-setters were autonomous and consider why they made the choices they did from the options available. Why might a doomed agenda be created? Three possibilities might explain

why: negotiators have no other choice; negotiators are duplicitous; or negotiators do not think it will fail. Each provides an explanation of subsequent reform failure.

This chapter will show how these elements combined and varied to shape the agenda. I find that there is little evidence of successful duplicity on the part of Ecuadorian negotiators, but ample evidence that some negotiators were autonomous 'true believers'. I find that crisis does seem to have made negotiators more autonomous from domestic constraints, but also that negotiators' own agency in making *themselves* more autonomous was a key factor when the crisis receded. For both agreements, this meant Ministers of Economy played a key role, and I consider their personal, political and institutional background and aspirations. Then, those who could have fulfilled a moderating role from the political side were prevented from doing so. In particular, the leftist minority party in the governing coalition, Pachakutik, which could have acted as a bridge between the IMF and the social sectors, was instead marginalised, patronised and ultimately expelled. At times the IMF failed to recognise that this would ultimately undermine implementation; when IMF members did notice, they could not stop it. Together, these points explain how the path of the IMF relationship, and especially the makeup of the IMF and Ecuadorian negotiation teams, generated a reform agenda quickly and harmoniously but ran into problems during implementation.

Figure 2.1: IMF relationship, 2000-2005



Source: ILDIS (2005) 'Economía Ecuatoriana en cifras', www.ildis.org; WTI spot price from EIA, www.eia.doe.gov.

I consider the period 2000-2005 in four stages, indicated in figure 2.1. In stage one, from January 2000 to November 2001, Ecuador was under pressure from the

recent crisis, with reserves and oil prices historically low. Ecuador agreed to an ambitious agreement... but then managed to renegotiate its terms extensively, obtaining numerous waivers. In stage two, from December 2001 to December 2002, although the oil price had dipped, reserves were even lower, and recovery was still fragile, Ecuador's economic leadership was able to prioritise political ambition over obtaining a new IMF agreement, and the relationship was at its nadir. In stage three, from January 2003 to May 2004, an insular and technocratic economic leadership enthusiastically negotiated an ambitious reform agenda, but then achieved only those targets over which the MEF had control. In the final stage, from June 2004 to April 2005, the MEF chose to implement an IMF-style agenda without a formal arrangement. In summary, as Ecuador's bargaining power improved, Ecuadorian officials perceived a dramatic change in their power in the negotiations, but the negotiated outcome does not reflect this, as state-level variables such as financing needs were compensated for by individual and institutional changes between the Noboa administration (stages one and two) and Gutiérrez administration (stages three and four).

This chapter will focus on the MEF because by 2000, it had become 'the only game in town' when it came to planning reforms. In contrast, in the early 1980s IMF agreements were negotiated by three institutions working together: the Central Bank, the MEF and the National Development Council, the latter somewhat akin to a Ministry of Planning. The National Development Council was established by the 1978 constitution and in the 1980s became an enormous state apparatus determining all economic and social policies. By 1990 the Council had three dedicated undersecretaries (of Economic Planning, Decentralised Planning and Social Development), and seven directorates, and central planning was at its zenith. In 1998, however, the National Development Council lost its quasi-Ministerial status and was replaced by an Office of Planning in the Vice-Presidency. The Office gradually lost prestige and independence and, eventually, influence over policy. In 2003, by decree, President Gutiérrez abolished the Office of Planning and replaced it with a National Secretary of Planning and Development administrated by the Presidency rather than

the Vice-Presidency. In theory, this was to be more prominent. However, in practice the institution was even less visible than the Office of Planning had been.[1]

Meanwhile, the Central Bank had been effectively castrated by dollarisation in 2000. There had always been institutional disagreements between the MEF and the Central Bank, the Central Bank emphasising monetary policy and the MEF fiscal policy.[2] But dollarisation removed the political influence the Central Bank had enjoyed via its determination of monetary policy and over the next five years it became essentially a statistics agency and economic advisory. The other major planning institution, the 'National Modernisation Council' (Conam), established in 1993, was always intended to be temporary and was a vehicle for wholesale privatisation rather than for development planning more generally. Never really effective, from 2003 onwards Conam, too, was reduced to an empty shell as a result of administrative incapacity (see Chapter Three).

Thus throughout the post-dollarisation period there was a 'planning vacuum' in Ecuador. As the ideology of central planning gave way to neoliberalism, all but one of the old state institutions of planning were weakened or sidelined. The exception was the MEF, whose functions expanded, including regarding the IMF. Before dollarisation, the IMF dealt with the President of the Central Bank, and the World Bank with the Minister of Economy. Today, the Minister of Economy represents Ecuador in both institutions. The organisation of this chapter therefore centres on changes at the MEF.

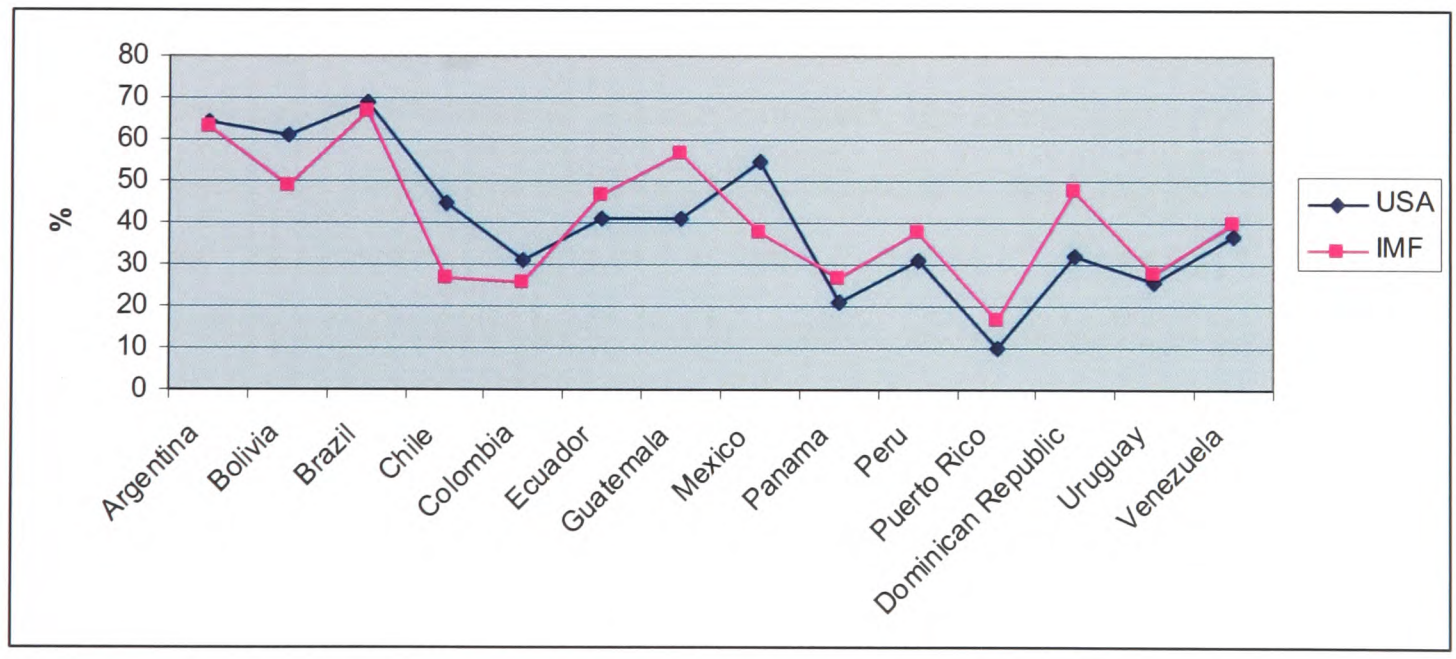
It is also worth briefly exploring the background of popular sentiment towards the IMF in Ecuador during the period under examination. In 2003, the Latin American and Iberian Government Performance Barometer surveyed citizens in 14 Latin American countries, including Ecuador. In Ecuador, of a range of institutions including the Andean Pact, the United Nations, the Organization of American States, the USA, President Bush, the European Union, Mercosur, and the IMF, the IMF had the strongest negative image (47%).[3] The only two which came close in terms of disapproval rates were the USA and Bush, with 41% and 43% each. There appeared to be a high level of awareness of the IMF's existence among Ecuadorians, since responses of 'don't know' were comparatively low for the IMF (14%, as compared to

[1] As an indication, the Secretary is barely mentioned on the website of the Presidency; there is no independent web presence.
[2] Interviews, MEF and Central Bank officials.
[3] CIMA (2003).

over 30% for several of the other institutions).[4] The IMF is frequently invoked as an enemy in popular campaigns, and political cartoons in major newspapers frequently featured the IMF as a character.[5] Social movements have made prominent the link between the IMF and unpopular policies such as liquid petroleum gas (LPG) subsidy removal, such that mass mobilisations have been against the IMF as well as against specific policies. The IMF came to frame debates regardless of its active participation; presidents come and go, but the antipathy towards the IMF has remained. *Fondomonetarista,* translating to something like 'IMF-er', has become an insulting epithet, used where anglophone leftist movements might use a broader term (such as 'neoliberal').

The negative perception of the IMF reflects a trend common in Latin America, with Ecuador slightly more 'negative' than the average. Across the region, negative perceptions of the USA correlate with negative perceptions of the IMF (see figure 2.2). In Ecuador, the IMF is often associated with foreign capitalism, especially American, and with colonialism and imperialism.

Figure 2.2: Percentage of respondents with a 'negative image' of the USA and IMF in 2003 Latin American values survey



Source: CIMA (2003). Latin American and Iberian Government Performance Barometer. Online at www.cimaiberoamerica.com/2003/in .

[4] Knowledge of the IMF's existence does not necessarily entail knowledge of its activities, as I found during a day spent interviewing Ecuadorians on the streets of Quito. Almost all I spoke to had heard of the IMF, many could say what 'FMI' stood for, most disliked it, but few could say why. Since my sample size was small, and my sampling technique not rigorous, the investigation should not be given much weight. I suspect, however, that a more formal study would reveal widespread ignorance of what exactly IMF policies are.

[5] For a collection of these, see Villacís Molina (2004).

The remainder of this chapter is divided into an examination of each of the four stages, preceded by 'stage zero' which briefly outlines the status of the IMF relationship in the years leading up to stage one.

Stage Zero, the IMF relationship before the crisis

This section examines the institutional relationship prior to stage one. This is necessary because the attitudes of some major actors in stage one were influenced by their experience of the crisis and the path of negotiations before 2000. In particular, we will consider why there was no agreement in the years immediately prior to 2000, to shed light on what changed afterwards. Throughout the late 1990s, Ecuador's long, frustrated negotiations never reached agreement. In 1998 the negotiators were close to agreement, but Ecuador's interim president, Fabián Alarcón, was increasingly politically vulnerable, and faced heavy societal pressure to avoid an IMF deal.[6] By the time his successor Jamil Mahuad took office in August, it was too late to avert crisis and agreement again faltered.

Alarcón's administration could not achieve an IMF agreement because he lacked political capital. This had not always been the case; his interim administration was borne of a popular uprising and Alarcón initially enjoyed public support simply because he was not his predecessor Abdalá Bucaram, the flamboyant and unpopular president ousted by Congress. Additionally, Alarcón's appointment as interim president had demonstrated support within Congress. [7] However, Alarcón's congressional support was short-lived and his interim administration, supported by a fragile multi-party coalition, was vulnerable to *quid pro quo* demands.[8] When interest groups began to apply pressure, his initially (relatively) coherent and tight fiscal policy began to loosen. Although economic pressures were mounting, popularly salient indicators of impending crisis—such as inflation, interest rates and currency depreciation—were not sufficient to galvanise popular support for urgent reform. Conversely, it was well known that an IMF agreement would imply austerity

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[6] For a revealing interview with Alarcón on the subject, see BBC (1997).

[7] The Constitution was held to be unclear on presidential succession and Bucaram's vice-president Rosalía Arteaga was passed over in favour of Alarcón, then President of Congress.

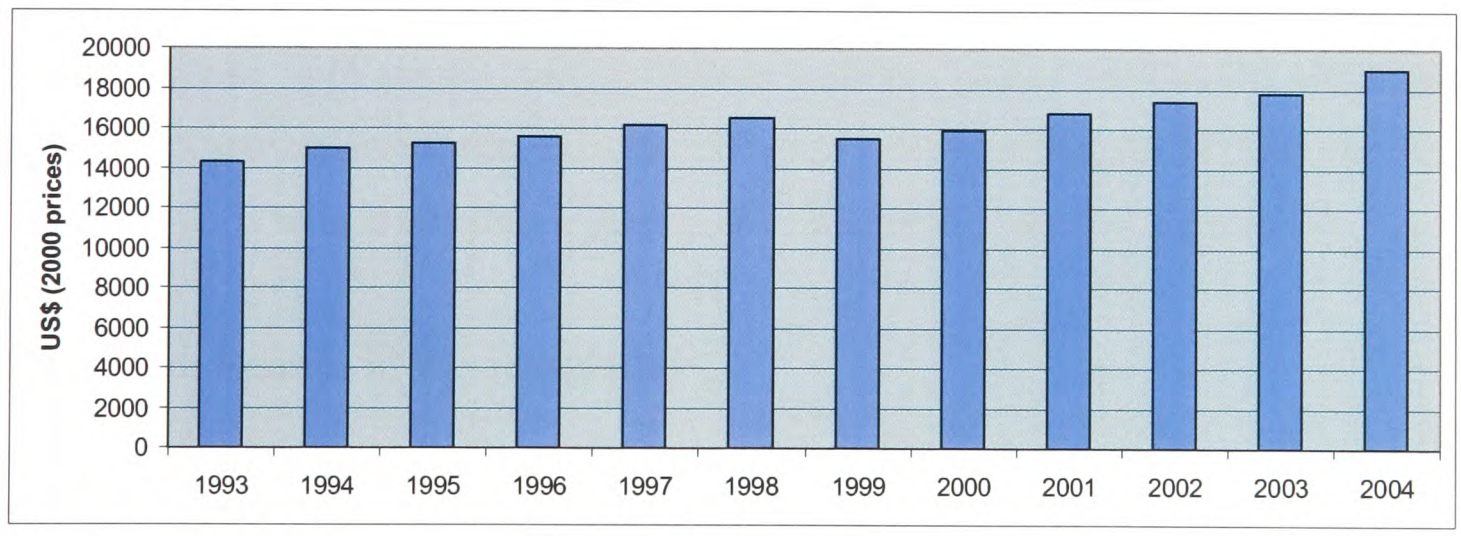
[8] Unfortunately, no opinion poll data was published for Alarcón's administration. However, the initial rumours that he would run for election as president after his interim period ended (for example, see *EIU Business Latin America* 1997), which came to nothing, are consistent with an initial wave of support which died down during his administration.

measures, including reforms that Ecuador had already repeatedly postponed with no obviously dire consequences. Lacking a popular mandate and representing a tiny party, Alarcón simply did not have enough political capital to shepherd IMF reforms through Congress or withstand popular opposition to IMF policies.

Alarcón's response to his vulnerability partly explains why his successor Mahuad was also unable to conclude an IMF deal. Against the wishes of many of his economic team, Alarcón began spending. Some expenditure was effectively permanent, such as public wage increases[9] and the 15% of the budget allocated to the municipalities.[10] Structural reforms were delayed. To make matters worse, oil prices were low (see figure 2.1).[11] The economic pressures began to compound. In the last quarter of Alarcón's administration several members of the economic team, including the Minister of Economy, resigned to protest his lack of economic discipline.[12]

Now is a good time to provide some detail on the economic crisis which began gathering steam around this time, since it is a crucial event in terms of this thesis. In 1999, GDP fell by over 6% in real terms (see figure 2.3). As inflation rose throughout the 1990s (see figure 2.4) the sucre-dollar exchange rate fell (see figure 2.5). By 1999, hyperinflation was widely feared as the sucre came close to free-fall.

Figure 2.3: Ecuador's GDP from 1993 to 2004



Source: IMF (2006).

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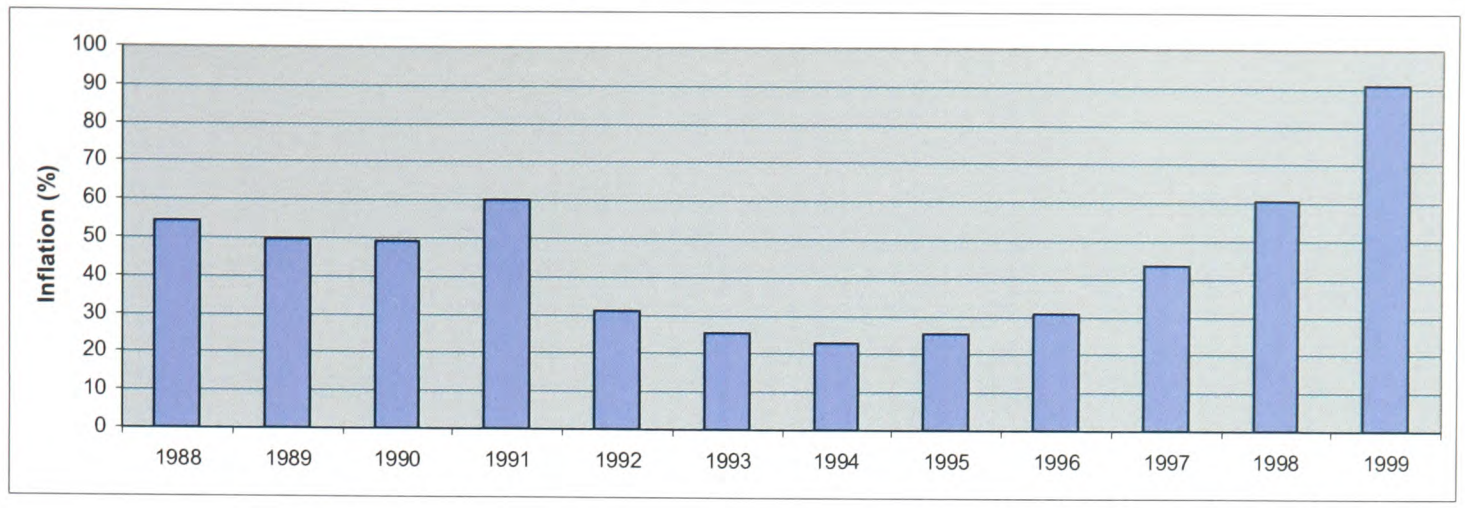
[9] Once raised, this line item is extremely difficult to reduce—especially in the sectors Alarcón increased, such as the highly-unionised teachers.

[10] Central government expenditure was to decrease accordingly, but never did. The IMF has consistently advocated that this 'earmarking' be removed, but it has proved politically impossible.

[11] Oil fell as low as $11.80 (Cushing WTI Spot Price) during Alarcón's presidency, much lower than at any stage from 2000-2005.

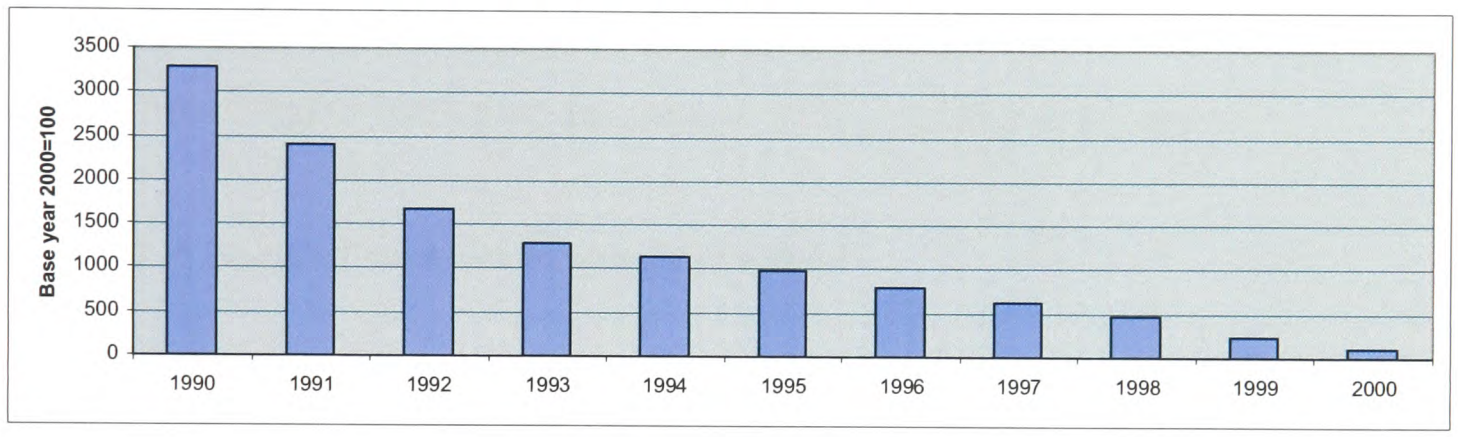
[12] Interview, Jaime Carrera, Acting Minister of Finance 1997-98, 30 March 2005, 10.15am, Quito. See also UPI (1997).

Figure 2.4: Annual variation in inflation



Source: ILDIS (2005).

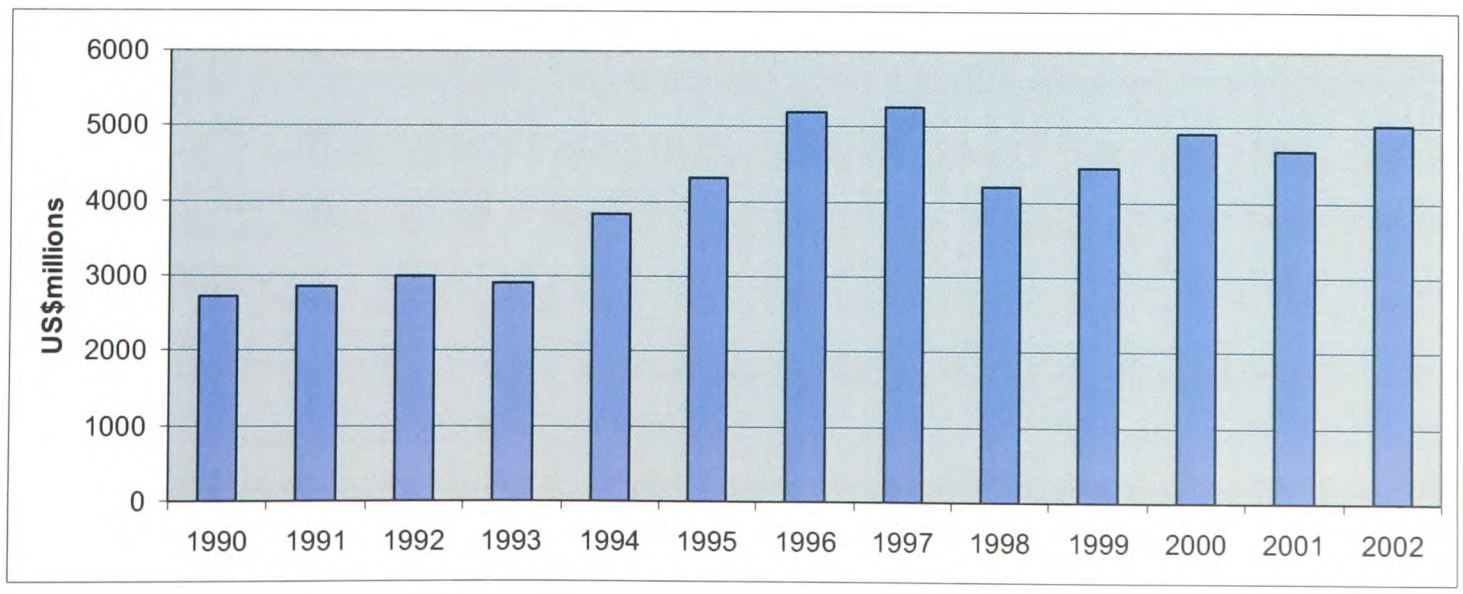
Figure 2.5: Sucre-dollar exchange rate in the 1990s



Source: IMF (2006).

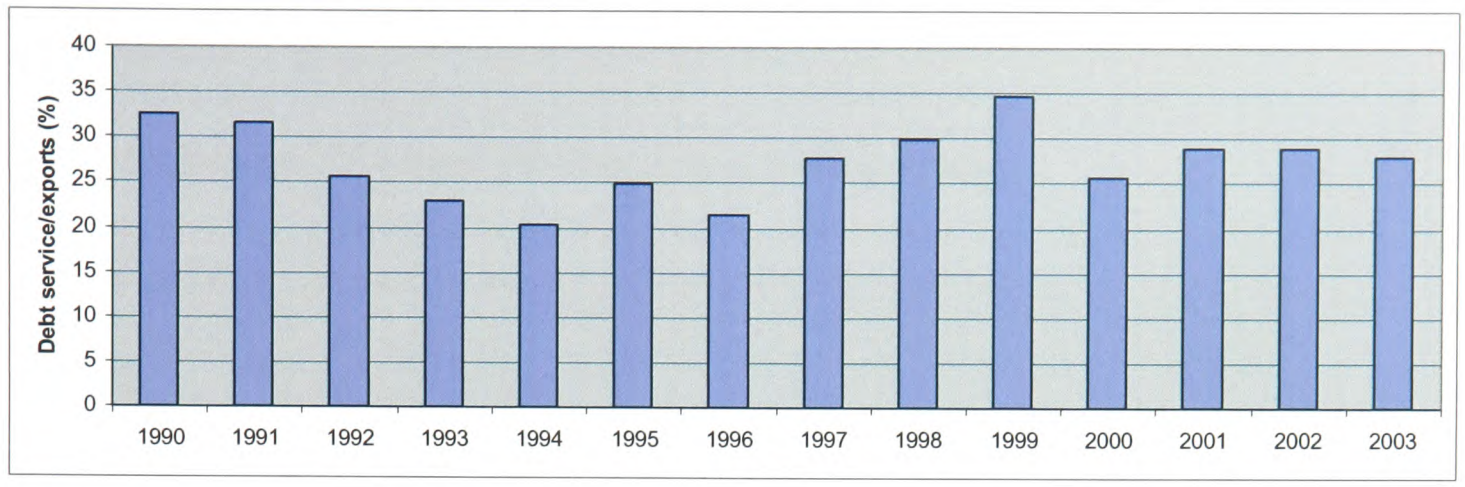
Exports had performed well in the early nineties. But after the *mancha blanca* (white spot virus) and *El Niño* weather pattern devastated important agricultural export industries, exports fell once more (see figure 2.6) and the debt service/exports ratio reached its highest point for several years (see figure 2.7).

Figure 2.6: Volume of Exports (FOB)



Source: IMF (2006).

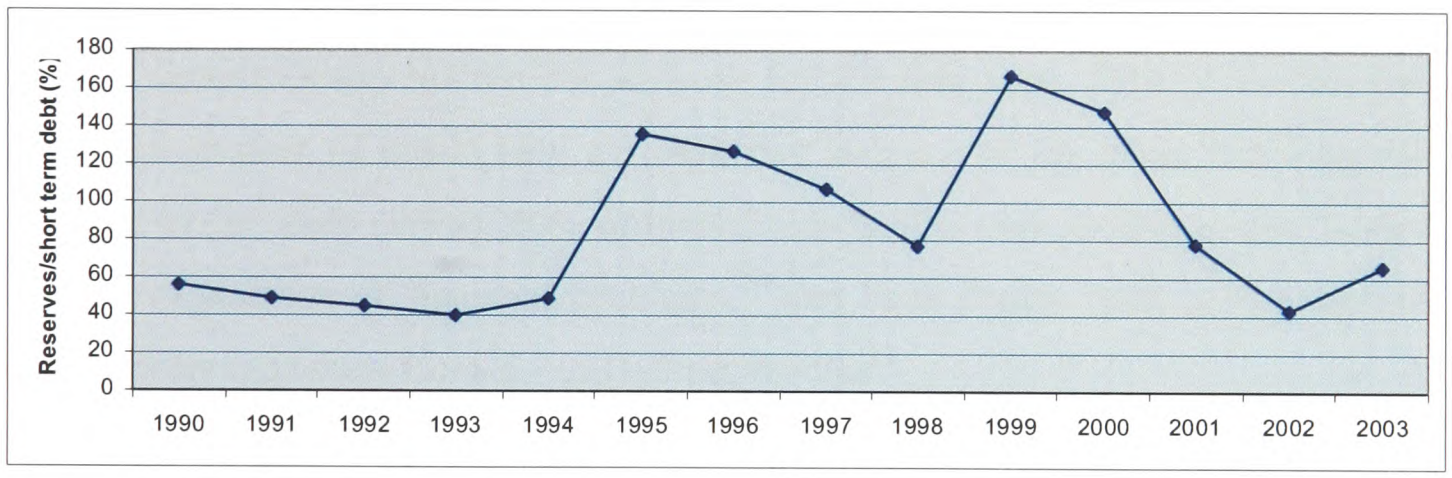
Figure 2.7: Debt service as a percentage of exports



Source: World Bank (2006).

A classic crisis warning signal is a country's ability to meet short-term debt obligations from current reserves. As figure 2.8 shows, this ratio has been highly volatile from 1990 to 2003. One dip came in 1998, just prior to the crisis.[13]

Figure 2.8: Ratio of reserves to short-term debt



Source: World Bank (2006).

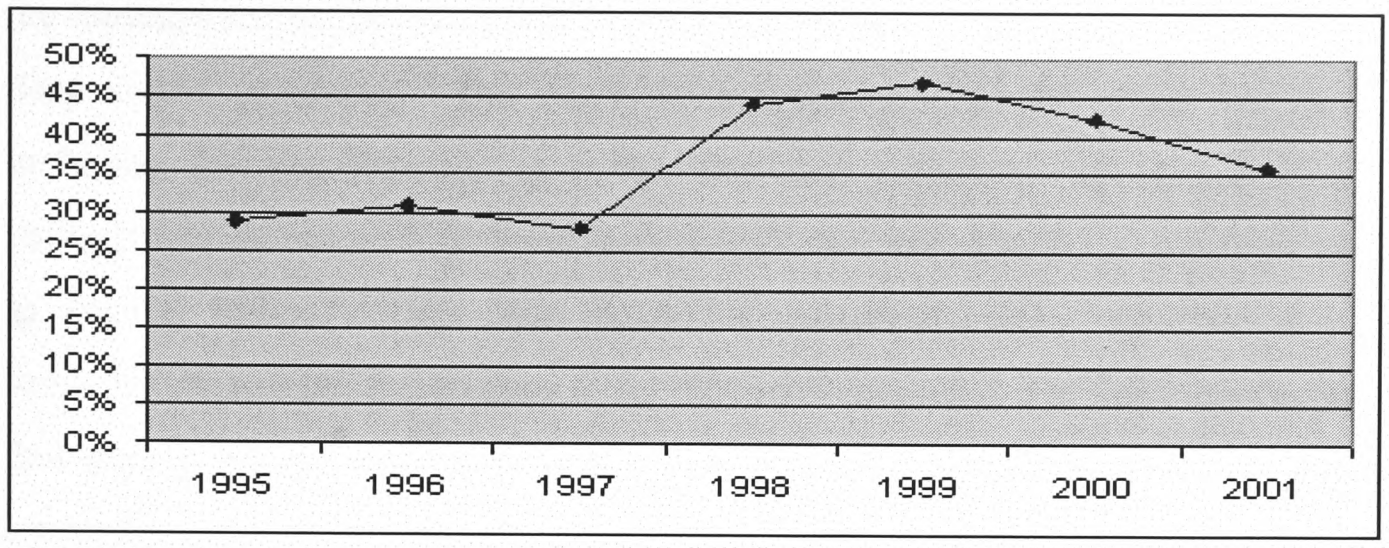
In social terms, the crisis was devastating. One economist called it "the most accelerated impoverishment in the history of Latin America".[14] From 1995 to 1999, households in poverty (measured by a minimum basket of consumption) rose from 3.9 million to 9.1 million, 34% to 69% (88% in rural areas).[15] Some estimates put the poverty rate in 1999 at 85% (but see figure 2.9 for a conservative, World Bank estimate).[16] Extreme poverty doubled, from 2.1 to 4.5 million, a rise from 12% to 31%. Poverty grew in relative as well as absolute terms, as the crisis was accompanied by

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[13] For more reflections of the crisis, see figures 4.2 (central government surplus/deficit) and 4.6 (total external debt as a percentage of GDP) in Chapter Four.
[14] Acosta (2002:2).
[15] Borja Cornejo (2000:42).
[16] Interview, Patricia Davila, Jubilee 2000, Guayaquil, 12 August 2003.

an increased concentration of riches.[17] The Gini coefficient for consumption rose from 0.43 to 0.48 and for income, from 0.54 to 0.59.[18]

Figure 2.9: Ecuador's urban poverty grows during crisis



Source: León (2002).

The results of this increased income poverty were dramatic: education rates fell, crime rose, especially among youth, more beggars could be seen on the streets, and many families sent children out to work for the first time. 58% of all families reduced the number of meals they ate each day because of the crisis.[19] During the worst year of the crisis (1999), 20% of households had to stop sending a child under 15 to school because of financial problems,[20] and days absent from school almost doubled during the crisis, from 5.4 to 10.5 per month.[21]

In August 1998, Alarcón's successor Jamil Mahuad was therefore taking office amidst a rapidly weakening economy and a volatile political situation. Negotiations with the IMF became more intensive under Mahuad's leadership, even culminating in a first draft of a Letter of Intent in 1999.[22] However, the letter was delayed by months and never presented to the IMF Board. The 18 months from November 1998 to March 2000 were, according to Stanley Fisher of the IMF, "an

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[17] While in 1990 the 20% poorest received 4.6% of income, in 2000 they received less than 2.5%, while the 20% richest increased their share from 52% to over 61%. See Acosta (2002:3).
[18] Borja Cornejo (2000:42).
[19] Fretes-Cibils, Giugale *et al.* (2003:329-31).
[20] Borja Cornejo (2000:44).
[21] Fretes-Cibils, Giugale *et al.* (2003:329-31).
[22] Interview, Central Bank official, Quito 2005.

exceptionally long and difficult period of negotiation", with IMF teams in Quito for over half of this time.[23]

These negotiations were protracted and difficult for several reasons. Firstly, the IMF was not impressed with Mahuad's response to a deep crisis of confidence in the banking sector. In late 1998 the IMF had begun to realise Ecuadorian banks had deep-rooted problems.[24] But Mahuad undertook "a series of ad hoc actions"[25] including freezing deposits in early 1999 and selective, highly politicised bank bailouts carried out without consultation with the IMF. The fiscal situation worsened as several billion dollars was handed to private bankers, most of this money immediately leaving the country.[26] As the crisis deepened, the IMF negotiators found that their reference data was continually outdated. Worse, they felt the Ecuadorian leadership was more interested in obtaining IMF finance for wages rather than implementing necessary reforms.[27]

For their part, the MEF team became frustrated at what they saw as the IMF's economic micromanagement and ignorance of the political climate as the crisis unfolded.[28] As is usual for Ecuadorian presidents, Mahuad lacked a majority in Congress. He was particularly vulnerable because of the economic crisis apparent to all, and the incipient political crisis becoming apparent to insiders.[29] As 2000 approached he became increasingly politically desperate. An IMF deal at this stage was fiscally desirable, as Ecuador faced a severe liquidity problem and low oil prices, and needed the funding the arrangement would have unlocked. However, an IMF deal was also obvious political suicide. Any conceivable arrangement implied deeply unpopular policies: raising VAT, fuel and gas prices, and other austerity measures and structural reforms. The Central Bank and MEF technocrats, who wanted an agreement, began to diverge from the politicians. Finally, conflict between Mahuad and the Central Bank came to a head when the Bank denied Mahuad credit. Mahuad never

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[23] Fischer (2000).
[24] A warning sign—foreign banks reducing credit lines to domestic banks—was corroborated by other data.
[25] Fischer (2000).
[26] The total amount is yet undisclosed. See Izurieta (2002) for a detailed discussion of this period.
[27] Interviews, IMF and MEF officials, Washington and Quito 2005.
[28] Interview, Minister in Mahuad administration: "Cutting the figures to the exact cent. Cuts that were ridiculous. $100,000 here, a million dollars there. And demanding and demanding. And the crisis couldn't wait. And the cuts were especially in the social areas, and demanding that the prices of public services went up. And it was impossible politically."
[29] This vulnerability allowed the populist Partido Social Cristiano (Social Christians Party, PSC) to force through a 1% 'financial transactions tax', a politically expedient policy reviled by the government economic team and often blamed for the massive capital flight and deposit runs which succeeded it.

again spoke to its President.[30] Then Mahuad declared a bank holiday by executive decree, without consulting the Central Bank. When it ended, Mahuad defied the IMF and Central Bank's recommendation to close some banks and reopen others, and the Board of the Central Bank resigned en masse.

Desperate, Mahuad opted to dollarise. This was intended to restore stability to the economy. Supporters argued it would increase transparency and spur productivity; on the other hand, it was irreversible and reduced policy space enormously. Dollarisation also immediately voided all the negotiations of the past two years, as the fiscal targets had to be recalibrated. The negotiations had been extremely detailed, with the IMF team repeatedly requesting small-scale cuts. To repeat them would have taken months. With Mahuad's attention occupied by his own political survival, he had nowhere near enough time. Just a few days after announcing dollarisation in early 2000, Mahuad suffered a *coup d'état* and was replaced by his Vice-President Gustavo Noboa.

One agenda item was successfully announced before Mahuad fell: the Brady bond default. In 1999, the concept of multilateral debt participation ('bailing in') was fashionable within the international finance community. The head of the IMF mission in Ecuador, John Thornton, had been a member of the team in Mexico's 'tequila crisis' when the IMF acted as a lender of last resort. That massive bailout, followed by the Asian crisis, sparked a change of heart within the G7, especially the US Treasury. By 1999, Ecuador's external debt had risen to 115.5% of GDP. Forty percent of government revenue went to debt service. As a former GM of the Central Bank of Ecuador said, "In that environment to organise a rescue package would have been very difficult. And Ecuador is a small, low cost experiment. No consequences for the system."[31] In late 1999 the IMF (allegedly) encouraged Ecuador to be the first to try its new 'burden-sharing' policy: that is, to default on $6.6 billion in Brady bonds, later followed by a second default on $500 million in Eurobonds.[32] The decision was

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[30] Interview, Luis Jácome, former President of the Central Bank of Ecuador, 16 September 2005, 4pm, Washington: "He told me – not directly, through his minister – tell Mr Jácome that if he calls me by telephone I will not answer."

[31] Interview, Augusto de la Torre, 16 September 2005, 10am, Washington.

[32] Ecuadorians involved tend to recall that the Fund encouraged Ecuador to default. This is vehemently denied by IMF officials, who emphasise that the IMF merely explained to Ecuador what its options were. But these were so few that Ecuador had little real choice. Stanley Fischer (IMF) said: "The authorities asked us what they should do. We said that the decision was up to them: if they defaulted, then there was a risk of disruptive legal challenges; if they paid, it would be difficult to sustain a viable cash flow position... Some claim that the IMF bullied Ecuador into defaulting on its Brady debt last

announced in September 1999, and in July 2000, Ecuador's Brady bond creditors agreed to write down 40% of Brady debt in exchange for securities including a sovereign global bond due in 2030.

Years later, top Ecuadorian officials still resent the 'burden-sharing' and moratorium on external debt. Some feel Ecuador was used as a guinea pig, and that while the experiment clearly failed, Ecuador was never recompensed. According to some Ecuadorian officials, the burden sharing was openly acknowledged at the time to be 'an experiment'. As one said, "We asked them, what do you expect to happen? And they didn't know how to answer... They never knew what they wanted. The burden-sharing was a disaster. We didn't get anything out of it."

Concluding this section, we can see why there was no IMF agreement: low support in Congress, discontinuities in leadership, and economic and political instability. This section has also sketched the institutional relationship before 2000. As Ecuador emerged from the economic crisis (not to mention the first *coup d'état* of the new century), some Ecuadorian negotiators entered IMF talks knowing that they were in a weak bargaining position but hoping for some kind of reciprocal benefit in return for being the IMF's 'guinea pig' in 1999. The IMF, however, did not appear to feel it owed Ecuador any kind of break.[33]

Stage One, January 2000 to November 2001

Of the four stages in this chapter, this first one best fits the prediction that a weak country agrees easily. After years of failed negotiations, Ecuador finally signed an IMF deal in April 2000, three months after dollarisation. What had changed was the economic crisis, which gave urgency to both sides. The Brady bond default had scared off private financiers, an effect which lasted years after the crisis,[34] and Ecuador was left wholly dependent on the multilateral lending organisations to finance its fiscal deficit. Ecuador also needed the IMF's help with implementing dollarisation, while the relationship had been damaged by their embarking upon dollarisation without consulting the IMF, who were sceptical. The IMF nevertheless gave Ecuador substantial technical help implementing dollarisation. But because of

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year. This is not true: we made it clear that private sector involvement would be necessary, but we did not advise them what to do about specific payments" (Fischer 2000). But as the Central Bank GM, de la Torre, said: "Clearly Ecuador had the final say, but there was no international structured assistance and so Ecuador was forced to do it." Interview, 16 September 2005, 10am, Washington.

[33] Interviews, IMF and Ecuadorian officials, Quito and Washington, 2005.

[34] By April 2005, Ecuador's debt was still rated CAA1 by Moody's.

these misgivings, the IMF's preference was for a tight, formal programme with numerous structural reforms.[35] The IMF clearly had the upper hand (in the words of one negotiator, "absolute control").[36]

The negotiations quickened and within three months an agreement was signed. There was less focus on prior actions than in 1998, and other formalities were dispensed with to hasten the deal and ensure dollarisation worked.[37] Despite the speed, the agreement was also unusually detailed, due to Ecuador's lack of credibility following the crisis and default, because of the severe structural problems in the banking sector, and because of the notoriously unstable political system, which the IMF teams had seen first hand since 1998.[38] As one official said, "The economic programme was very detailed. Very small things. I never saw anything like it. When I asked them why they did that, they said, 'Because we don't believe you. We don't believe Ecuador. You don't have any credibility'."[39]

As well as Ecuador's weak negotiating position, the team lacked expertise at the highest level. The Ecuadorian economic team was led by the Minister of Economy, Jorge Guzman. Guzman had been the Superintendent of Banks under Mahuad. However, he was a lawyer, not an economist. The problem was not that Guzman disagreed with the IMF or damaged the relationship—it was the opposite. Guzman's lack of experience in economics made him pliable. As a later Minister of Economy said, "He doesn't know economics. He had some advisers, he signed and that was it." Against the wishes of his economic team, Guzman committed to policies in areas that, according to officials on the team, he did not fully understand or even discuss.[40] As one said, "It was too easy [for the IMF]. He gave up too many things, and the agreement was very, very harsh."[41]

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[35] Interview, IMF official in 2000.
[36] Another characterised the mood as, "We need an agreement, where do we sign?"
[37] Interviews, Ecuadorian and IMF officials.
[38] IMF officials, Washington, 2005.
[39] The agreement was also far-reaching and closely monitored. There were long lists of data to be provided to the IMF daily, weekly and monthly, together with the maximum acceptable delays in providing the information (see Government of Ecuador 2000a). Catch-all clauses gave the IMF a wide ambit of influence. For example, "Develop a comprehensive debt restructuring strategy, *acceptable to the IFIs*" (Government of Ecuador 2000a).
[40] Mauricio Yépez, later Minister of Economy, but at that time working for the IMF, commented: "The power of the government was absolutely zero. 'Where do we have to sign?'... and the Minister signed. He didn't discuss anything that he was signing. So it was easy, but we didn't comply with anything in that programme." Interview, 7 April 2005, 11am, Quito.
[41] On the other hand, IMF officials said Ministers of Economy are often not economists, and stressed Guzman's intelligence and the inevitability of several measures.

The 2000 Letter of Intent committed the government to "a more flexible labor market"; social security reform including private participation; construction of the new oil pipeline; reducing domestic fuel subsidies; improving tax administration and introducing a "comprehensive tax reform package"; controlling the public wage bill; raising electricity tariffs then privatising both generation and distribution; privatising the telecommunications companies; and engaging private management for sewage and water supply in Guayaquil, the ports of Guayaquil and Esmeraldas, and the state oil refineries. These commitments were governed mostly by loose conditionality. Tight conditions (performance criteria, structural benchmarks and indicative targets) were exclusively fiscal, and prior actions mostly concerned the banking and financial sector reforms (as well as explicit commitments to increase VAT and fuel prices). Much of the 'looseness' of the agreement's conditionality arises from the enormous variance in the ability to measure and evaluate compliance. While some goals were clear and time-referenced (such as telecommunications privatisation "during 2000"), others relied on highly subjective judgements (private participation in pensions "as soon as the health of the financial system has been restored") or were vague and unmeasurable ("development of an effective and impartial judicial system").

Despite this 'loose conditionality', there were enough clear commitments to be able to state that virtually none of the structural reforms planned in the 2000 agreement have actually occurred. Even five years after the agreement—that is, four years after the scheduled finish date—the only reforms implemented are the sewage and water concession and the oil pipeline.[42] The others were never completed: labour and social security reforms failed repeatedly in Congress; fuel subsidies remained high; reform to tax policy mostly failed; the wage bill increased; electricity tariffs were unchanged and nothing in either the state electricity or telecommunications sectors was privatised. The two main ports and the oil refineries remained under state control, with their concession repeatedly announced as imminent throughout the five-year period but never completed.[43]

With a detailed, comprehensive agreement signed so quickly during a crisis, by a team led by a lawyer whose colleagues say neither questioned nor truly understood what he was signing, it is hardly surprising that it proved impossible to

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[42] And even then, the sewage and water utility concession was conducted by the municipal rather than central government.

[43] As of the end-point of this study, April 2005.

comply with. Agreement was quick because the crisis made the negotiating team autonomous. But those who had to implement the agreement found that it had been made without a real understanding of Ecuador's structural limitations and its emergence from a deep economic crisis. As the then General Manager of the Central Bank said,

> "When we started looking at the outcome agreement with the IMF we found that it was really impossible to comply, especially the part relating to the banking sector. They wanted to do everything by the book, according to the Basle accords. We were then starting to get out of this terrible economic crisis, we had lost half of the private banks in the crisis, and the rest of them were not in a very good position. So the best thing to do was to help them, to improve their situation and to put them in a new situation, but slowly, not immediately as the IMF wanted. And that was an example. The same thing happened in other parts of the agreement."

The agreement had to be renegotiated almost immediately. In August 2000, waivers were requested for central government non-interest payments arrears and for failing to increase LPG prices.[44] In May 2001 further waivers were requested for central government expenditure, the structural performance criteria on recapitalising banks, applying Basle standards to the composition of bank capital and, again, fuel and gas price increases. After a VAT increase was declared unconstitutional, the IMF again granted a waiver. In fact, the number of waivers in the 2000 standby was an IMF record. Consequently, even though few reforms were implemented, the programme was deemed 'completed'.

As this shows, the factors which catalysed agreement failed to catalyse implementation. For three reasons, the IMF's influence and tight control turned into flexibility. Firstly, the IMF team in 2000 had been involved with Ecuador throughout the late 1990s, including the Brady bond default. Just as there was some resentment on the part of the Ecuadorians as 2000 progressed, there seems to have been *some* feeling of responsibility on the IMF side.[45] Ecuadorians made sure to remind the IMF

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[44] Government of Ecuador (2000b).

[45] As one official said, "[The IMF mission chief] didn't understand that there was a terrible crisis unfolding … The IMF has always been a little myopic. After the coup it was as if the IMF realised it

team members of their part. Secondly, there was a reluctance to sully individual reputations by being associated with a 'failure', and an individual incentive to be associated with a successful exit from crisis and entry into dollarisation.[46] Because debt remained so high, IMF flexibility was essential to the success of the dollarisation. As one informed observer said, "I asked friends in the IMF, 'Why not pressure us? Why didn't you make declarations against the government?' The answer was always the same: it was a new government, interim, starting the dollarisation, we had to be very cautious. We didn't want a crisis in Ecuador again." Thirdly, there was international support for the IMF's tolerance. Ecuador was seen as economically and politically fragile during the Noboa administration, and there was strong international will to ensure dollarisation succeeded.

The IMF team faced career incentives to having Ecuador complete the agreement, but, equally, incentives to ensure Ecuador did not default. This created a tension between the drive to give many waivers (and thus increase Ecuador's chances of completing the agreement) and the drive to force Ecuador to make the reforms specified in the agreement. In particular, the fiscal reforms were seen as crucial to avoid a second default. Implementation thus firmly focussed on fiscal targets, directly relevant to avoiding a second default, with other (structural) reforms easily abandoned. The inclusion of these disposable structural reforms in the first place is hard to explain—but follows practice elsewhere. The IMF suffered criticism for tacking on superfluous, opportunistic conditions in transition countries and also following the Asian crisis, notably in South Korea.[47] Despite this criticism, in the 2000 agreement the IMF repeated the practice of adding conditions not strictly necessary to emerge from crisis (for example, a "more flexible labour market", various privatisations and even construction of an oil pipeline, a project which would take several years to complete). MEF technocrats agreed that deep structural problems had contributed to the crisis, and even agreed on the specific reforms needed. But to the Ecuadorians,

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really failed... Even though they would never admit this publicly, they knew they failed and saw the crisis of 2000 with a bit of sensitivity."

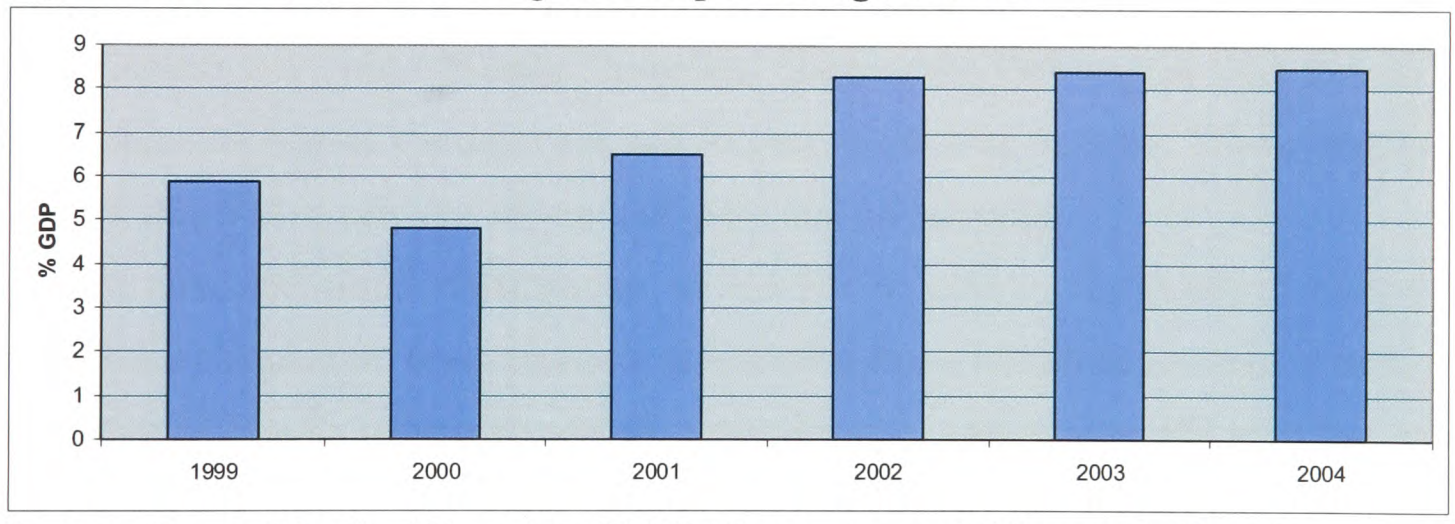
[46] As one MEF official said, "In 2000, John Thornton didn't want Ecuador to default again... So they ended up disbursing everything even though there was very little actual commitment from the government... The team was looking good because they were getting out of the crisis and the dollarisation was going well."

[47] See especially Feldstein (1998): "The IMF is now acting in Southeast Asia and Korea in much the same way that it did in Eastern Europe and the former Soviet Union: insisting on fundamental changes in economic and institutional structures as a condition for receiving IMF funds."

immediately after a devastating crisis seemed the worst time to attempt the mammoth political task of implementing these reforms.

During the implementation of the 2000 agreement Ecuador outperformed everyone's fiscal predictions, and most fiscal targets were met or exceeded, some dramatically.[48] This was due to both unexpectedly low expenditure and unexpectedly high revenue. On the expenditure side, dollarisation at a high rate of 25,000 sucres acted like a massive devaluation, decreasing the public wage bill in 2000 (see figure 2.10). Ecuador's budget is sent to Congress in September, approved by November and enters execution in January. This meant the budget was sent before the currency crisis, with an exchange rate of approximately 10,000 sucres, but entered into force at 25,000. Expenses fell dramatically as sucre wages were converted to dollars at the higher (cheap) rate, while income, particularly oil, was constant in dollars. In other words, the internal spending commitments made by the central government—wages, contracts, and so on—were much lower than expected. The drop shown in figure 2.10 could have been achieved by redundancies, but this was not the case; it was a temporary wage squeeze.

Figure 2.10: Public sector wage bill as percentage of GDP



Source: Central Bank of Ecuador (2005) 'Operaciones del Sector Publico No Financiero', www.bce.fin:ec.

On the revenue side, increases were mostly due to high oil prices during 2000 (see figure 2.1), and higher tax take. We shall ignore the reasons oil prices rose, as the world price is exogenous to Ecuador, but it is worth noting why tax revenue increased. Firstly, there was a large difference between tradable and nontradable inflation in 2000. In the tradable sector, there was very high inflation; in the nontradable sector,

[48] The first review praised the authorities for a fiscal position "significantly stronger than anticipated" IMF (2000). The sizable primary surpluses achieved are particularly remarkable in light of the one-off payments made in 2000 to the banking system (Carrell 2004).

low.[49] In Ecuador, the incidence of taxes is relatively higher on tradables; VAT is a high proportion of the total tax take. In contrast, there is little or no tax on education, real estate, and—to a large extent—salaries. The high rate of inflation on the goods which were taxed increased revenue, and VAT itself increased from 10% to 12%. Meanwhile, the lack of confidence in banks and other forms of investment induced a consumption boom, which further increased VAT revenue. A major factor during 2000 and 2001 was the construction of a second oil pipeline which accounted for 5% of GDP and whose materials were mostly imported, meaning it made a major tax contribution. Thirdly, a new tax administration was extremely successful (see Chapter Four). Thus in early 2000 Ecuador had a frozen budget in which salaries and pensions were low, and oil and tax revenues had dramatically increased. With little effort, the fiscal targets in the IMF agreement were met and even surpassed.

Clearly, then, Ecuador's ability to officially 'complete' the 2000 agreement should not be taken as evidence of IMF influence over domestic management; or of a coalition for reform forming around tough measures; or of increasing dispersed costs undermining support for the status quo; or of 'learning effects' feeding into an improved design process; or of radical, technocratic reforms backed up by sanctions—several of the options mentioned in the literature cited in Chapter One. The agreement was only officially 'complete' because the IMF was willing to only 'count' certain kinds of commitment and to issue numerous waivers. Where targets were met, this was mostly due to windfall gains and dollarisation.

In turn, successful dollarisation should not be seen as the result of careful planning and calculation, or as evidence of effective threat of sanction. There is much evidence of Mahuad's indecision and the lack of studies surrounding the selection of the 25,000 sucre conversion rate.[50] Neither the Ecuadorians nor the IMF knew how

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[49] This is normal after large devaluations, as tradable goods take international prices faster than non-tradable.

[50] See Carrell (2004) for detailed discussion of Mahuad's unplanned decision. "There is no doubt this is being done not based on economic reasoning but on political reasoning," said Federico Kaune, senior economist for Goldman Sachs in New York. "The problem is, the Ecuadorian economy doesn't have the kind of fundamentals needed to successfully complete dollarization." (Faiola 2000). The *Latin American Weekly Report* said "it is now clear that President Jamil Mahuad announced the 'dollarisation' of the Ecuadorian economy before he and his government had worked out how they were going to go about it." (*Latin America Weekly Report* 2000a). Two days after dollarisation was announced, the *New York Times* reported Mahuad threatened to fire any central bank official opposing the plan, and that it "remained unclear... exactly how it would work" (Rohter 2000). "What is occurring continues to suggest to me a lot of confusion," said Marc Helie, a director of the Ecuador Creditors' Advisory Group. "We don't even know if they have a consensus to implement the dollarisation plan as they have presented it" (Rohter 2000). The IMF was also against the plan. IMF

dollarisation would change the analysis used in the 1999 negotiations. The negotiations had begun well before dollarisation was contemplated, with fiscal parameters and potential prior actions planned in 1999.[51] As one official who was heavily involved recalled,

> "We entered this new ambit of dollarisation that neither the IMF nor us, nor anyone, really knew. Everything was uncertain. So we fixed 1% or whatever as a goal. It seemed reasonable. We looked at our historical performance, and we'd always had deficits. So we said, we'll try to minimise the deficit, make the 2000 deficit less. That would be an important advance. What neither the IMF nor us predicted was that we would have a surplus!"

The only truly significant state-led contribution to Ecuador's recovery and compliance with the fiscal targets was the increase in tax collection. I investigate this in depth in Chapter Four; for now, let us say that this was an institutional process better viewed as having begun in 1998 and was certainly not catalysed by the 2000 agreement.

While those managing the fiscal accounts saw austerity as a benefit of dollarisation, those managing the political side saw it as a time bomb. Civil servants protested their lost real wages, pressuring Ecuadorian politicians to spend. On 15 May, 2000, 140,000 teachers struck over wages, sending three million children home from school. The strike lasted several weeks, protests were tear gassed, and 300 teachers went on hunger strike. Noboa agreed to increase starting pay rates by 81%, and not to privatise the public school system; a clear violation of the Letter of Intent.

Having originally supported the IMF programme, as the fiscal situation stabilised Noboa made further concessions. After raising teachers' wages, he also increased the 'Solidarity Bond', the welfare transfer to Ecuador's poorest, by 75%, rather than 50% as in the IMF programme. Furthermore, the concessions made in mid-2000 did not prevent a further, more militant set of general strikes in early 2001, when several people died in ten days of national protests and an estimated $300

Managing Director Michel Camdessus said "Dollarisation was not, I must be frank, the kind of policy we would have recommended at this stage to Ecuador" (Hanke 2003).

[51] Interview, Central Bank official, Quito, April 2005.

million damages were caused.[52] This time, the government responded by reversing a 20% LPG price increase and freezing petrol tariffs for a year. Health workers struck again for 42 days in mid-2001, closing hospitals and clinics. Ecuador negotiated a two-month extension of the IMF programme, then a six-month one. In April 2001 Standard & Poor's downgraded Ecuador's long-term foreign currency credit rating to CCC+ from B-, making it the only country rated 'C'.[53] Despite this, for reasons explored above, in December 2001 the final tranche of the 2000 agreement ($95 million) was released.[54] Nevertheless, as stage one ended Noboa's concessions began to damage the relationship.

This stage has shown how crisis can cut both ways in catalysing reform. Crisis increased autonomy from domestic constraints and catalysed long-elusive agreement. However, during implementation, institutional and personal incentives to give waivers combined with a domestic disinclination to undertake difficult reforms. Moreover, although agreement was quick, technical problems became obvious during implementation. Then, not only were the fiscal targets of the 2000 agreement met almost by chance, but even these 'wins' were undermined by their own success. Fiscal austerity was possible during the crisis, but was strongly opposed only a few months afterwards. Because Noboa was politically weak as a result of the crisis, he was vulnerable to public opposition. The lesson: the crisis cut both ways.

Stage Two, December 2001 to December 2002

Within days of the final tranche of the 2000 agreement, an IMF mission arrived in Quito to begin negotiating a new agreement. This time, there was more prominence given to structural reforms.[55] However, despite both sides' apparent desire for a new agreement, in stage two the Ecuadorian leadership was clearly less committed. As strikes continued, expenditure rose and Noboa became increasingly outspoken against the IMF, while simultaneously expressing commitment to an agreement.[56] In January 2002 the government announced an agreement might be

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[52] EIU (2002).
[53] Euromoney Institutional Investor (2001).
[54] *Agence France Presse* (2001).
[55] The IMF press releases accompanying the final tranche of the 2000 agreement urged Ecuador to embark upon structural reforms (*Agence France Presse* 2001), and Noboa pledged to increase private investment in oil, electricity and telecommunications (Kerr 2002c).
[56] EIU (2004b).

concluded within the month,[57] but in fact negotiations continued throughout the year and the new agreement never came. A key development was the appointment of Carlos Julio Emanuel as Minister of Economy. Emanuel's appointment in December 2001 marks the beginning of the second stage: no IMF agreement and no real intention to negotiate one.

Was this because crisis had receded, or is there some other explanation? I argue that lack of agreement is better explained by key players' ideology and political commitments within the institutional constraints they faced. Noboa and Emanuel increased spending in response to domestic factors, but they did have other options, and some of the constraints were due to their own choices. After the crisis, there was wider latitude given to individual policymakers to act according to their own ideology. The balance between these factors will be further discussed in this section.

For the first two years of the Noboa administration, the economy had performed well. But in 2002 spending rose dramatically. The public sector wage bill rose to almost $2 billion (9% of GDP)—the highest it had been since 1998, shortly before the crisis (see figure 2.10).[58] The 2002 budget was denominated in dollars, with no (fiscally) fortuitous devaluation as in 2000. This exposed the weakness of Noboa's fiscal management. Moreover, until 2002 Noboa had been at least partially restrained by tough fiscal management from the MEF. In 2002, however, Noboa appointed Carlos Julio Emanuel as Minister of Economy in a political deal with the PRE party.[59] Emanuel was experienced and intelligent, flamboyant and politically ambitious, but caused damage to the IMF relationship which took years to recover.

Officials, analysts and others interviewed for this thesis tend to explain this breakdown solely in terms of individuals' personalities and background, especially Emanuel's. Several of the team, including the new mission chief Bob Traa, had worked in Argentina and were keen to avoid the same mistakes in Ecuador. But where Traa seems to have seen a looming Argentina-style crisis, Emanuel seemed less concerned. This produced conflict. Although interviewees described both in glowing terms regarding their economic expertise (Traa by interviewees as "one of the best economists I've ever met", ".... the best mission chief as an economist", Emanuel as "the smartest guy at the table... always the smartest guy at any table. Very smart, very

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[57] Kerr (2002a).
[58] Moss (2002b). The wage bill rose by 51% in 2002 alone. EIU 2004a. This underscores the point that compliance with the 2000 agreement had little to do with IMF influence over domestic management.
[59] Interviews, Quito 2005.

sharp,"), they were seen as polar opposites in terms of how seriously they took their job: Traa as "one of the most responsible people I've ever met", "straight, stubborn", Emanuel as "disorganised", "really irresponsible", and "not taking take his job seriously".[60] Spending on Emanuel's watch also increased dramatically, against the wishes of the IMF. The Central Bank did what it could by denying some requests for external financing, but was unable to prevent many of the increases.[61] Emanuel had already shown signs of the populism that would do such fiscal damage: as GM of the Central Bank from 1984 to 1988 he had increased the staff roll from 3,500 to 6,000 employees[62] (according to one who succeeded him, turning it into a "bloated", "populist" institution in "disarray").[63] In 2002, Emanuel's spending is generally attributed to his political ambitions. He had been a presidential candidate in 1998 for the PRE, retained excellent relations with the PSC and its supporters and, apparently, wished to run for office again.[64] As another former Central Bank GM summed it up:

> "He is a well-prepared economist, he has experience, but he was interested in politics. He wanted to be a presidential candidate for the PRE. So he started spending more than was actually in the budget or the economic programme. The President had to fire him. But for the short period he was in charge of the Ministry, he did a lot of damage. He gave money to everybody."[65]

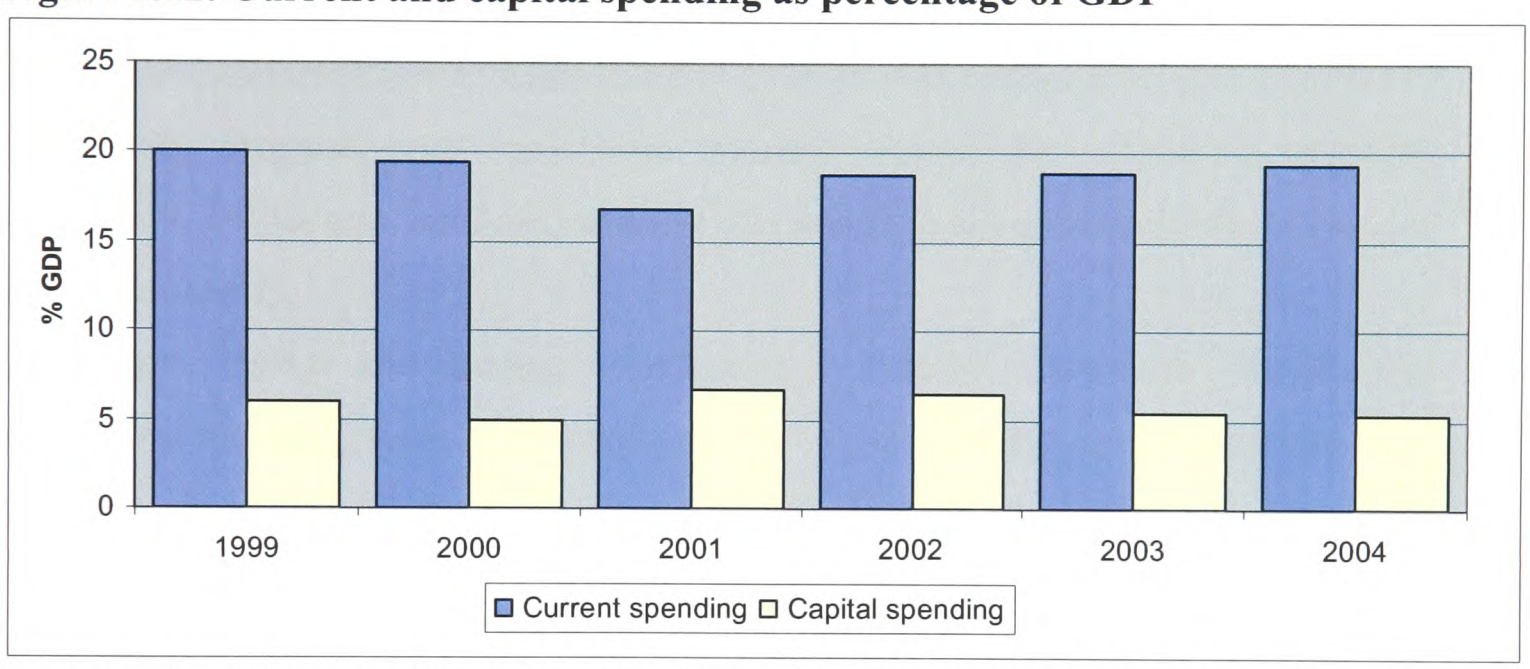
This is only a partial analysis, however, for two reasons. Firstly, although responsibility is often ascribed to Emanuel, he would not have been able to act towards the IMF in such a cavalier manner or to increase spending had Noboa opposed him. In fact, there is reason to ascribe much of the spending to Noboa himself. Emanuel controlled capital spending, Noboa current spending. While current spending rose from $2.28 billion in 2000 to $3.7 billion by the end of 2002, capital spending only increased from $1.4 billion to $1.5 billion and, as figure 2.11 shows,

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[60] Interviews, MEF and Central Bank officials, Quito, April 2005.
[61] Interview, Mauricio Yépez, former GM of Central Bank, 7 April 2005, 11am, Quito: "We were worried".
[62] De la Paz Vela (2004: 63).
[63] Interview, Augusto de la Torre, GM of Central Bank (1993-96), 16 September 2005, 10am, Washington.
[64] De la Paz Vela (2004: 63).
[65] Interview, Leopoldo Baez, 21 March 2005, 11am, Quito.

actually decreased as a percentage of GDP.[66] Capital spending includes public works spending, a politically important source of favours and patronage, but not a large component of the Ecuadorian budget. Current spending includes salaries. Noboa himself managed the public service salary relationship (in contrast, Gutiérrez left it to the MEF). When Noboa raised salaries in response to the continual public sector strikes, the Central Bank, strongly opposed, was powerless to stop him.[67] The 2004 World Bank Public Expenditure review found that "most, if not all" budget increases after 2000 went to teachers' salaries."[68] Figure 2.10 shows the increase in the wage bill since 2002.

Figure 2.11: Current and capital spending as percentage of GDP



Source: Central Bank of Ecuador (2005) 'Operaciones del Sector Publico No Financiero', www.bce.fin.ec. [69]

Secondly, to more fully explain why spending increased and the IMF relationship suffered, it is important to balance the significance of 'personality' against Emanuel and Noboa's institutional constraints. Considering their room to manoeuvre also sheds light on why an IMF agreement was not reached during this period.

As with Emanuel, interviewees who saw Noboa as at least partly responsible for increased spending offered personal explanations. Some officials felt Noboa had a genuine ideological commitment to higher spending, others that he was ignorant of the economic consequences. One friend of Noboa's attributed the difference between

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[66] Figures shown to me by Ramiro Galarza, Vice-Minister of Finance, 7 April 2005, 12pm, Quito.
[67] Interview, Leopoldo Baez, former General Manager of Central Bank, 21 March 2005, 11am, Quito.
[68] Izquierdo, Melo et al. (2004).
[69] GDP fell sharply in 1999-2000 so relative spending is high for these years.

Gutiérrez and Noboa to Noboa's strong Christian background and concern for the poor.[70] Another official felt it was "a desire for an easy life", and several that Noboa was unaware of the gravity of the fiscal situation.[71] Let us put these in context by considering the incentives both Noboa and Emanuel faced.

There were credible rumours that Noboa wanted to run for president (and no clear successor throughout his term). Noboa would have known that austerity policies would kill his chances. If both Emanuel and Noboa were considering political candidacy, both had political motives to spend and to avoid being seen as too close to the IMF. Ecuadorians with presidential ambitions must usually make expansive promises, and the electorate generally responds to nationalist and populist rhetoric. Being seen as a 'lapdog' of the IMF or the US Embassy is also a clear electoral liability—and candidates who have recently been in office should be able to point to their record. Emanuel may have been unfairly blamed for increasing spending dramatically, but he may not have resented this image at all, as it probably helped his electoral prospects.

Then, Noboa and Emanuel each had individual constraints. For Noboa, pressure was mounting from strikes and protests. As we saw, his predecessor had been overthrown in a *coup d'état* amid mass uprising. Furthermore, Noboa had presided over dollarisation and the effective devaluation, so many attributed the plight of Ecuador's wage-earning classes to him. Noboa had very little support in Congress and no particular relationship with the military, which had played a key role in the *coup d'état*. Highly vulnerable, Noboa had good reasons to want to spend and to avoid signing an IMF agreement which would necessitate unpopular reforms, and—especially since he never worked closely with the IMF—no real motivation to stop doing so.

For Emanuel, committing to several reforms likely to be included in an IMF agreement would compromise his relations with his coastal party constituency. As Chapter Three will show, several reforms in the 2003 agreement were opposed vociferously by the same political forces on the coast that supported Emanuel's tenure as minister. Emanuel could not repeat the events of 2000 and sign an empty agreement trusting to later waivers, since by 2002 the IMF was emphasising prior actions instead. Instead, delays in signing an agreement worked in Emanuel's favour

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[70] Rafael Correa, Professor of Economics, University San Francisco Quito, 29 March 2005, 4pm, Quito.
[71] Interviews, MEF, IMF and Central Bank officials, Quito and Washington 2005.

and in favour of his elite political constituency. Although he was earlier accused of "not taking his job seriously", Emanuel could be said to have taken it very seriously indeed—if his real job is understood to be representing those who had aided his appointment.

Beyond these constraints, however, personality and individual attributes did have an impact. Emanuel was a shrewd and intelligent political operator, able to distract the IMF for months and to divert attention from countervailing legislation (see Chapter Four on the FRTA). His willingness to obfuscate figures and use unorthodox negotiation tactics allowed him to delay an IMF agreement until it was too late in Noboa's term for one to be considered. Crucially, neither Noboa nor Emanuel showed any ideological commitment to the neoliberal project. Had they been committed to IMF reforms, they could have accepted that the price to be paid included relinquishing any hope of electoral candidacy, and perhaps risking their own tenure; they did not share such an ideology. As for the IMF, Traa's economic expertise helped find holes in Emanuel's data and arguments, and his scepticism of Emanuel underpinned the prior action strategy, but ultimately Traa and his team were reliant on the Ecuadorians' willingness to provide accurate data, and could not hasten the process alone. Traa's personal agency was significant when he recommended against a loan to Ecuador at all, a decision which could realistically have gone the other way under a different mission chief.

Emanuel's strategy to avoid an austere stand-by arrangement appears to have been to postpone the decision without ever actually declining it. So, according to the official who was acting as go-between, "Bob Traa and Emanuel started getting fed up with each other. Bob took his job seriously and Emanuel basically didn't."[72] The Ecuadorian economic team was split: while the rank-and-file technocrats, seeing themselves as long-term planners, wanted an IMF accord, the economic leadership—which included the three key actors, the President and two Ministers of Economy (Emanuel and his successor Arosemena)—did not want one.[73] As reports grew of Emanuel misleading the IMF, mission chief Bob Traa grew increasingly frustrated,[74] and the relationship steadily deteriorated. Finally, Traa recommended against doing business with Ecuador. In response Emanuel sent a letter to Traa's superior at the IMF

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[72] Interview, Ramiro Galarza, as above.
[73] Interviews, MEF, central bank and IMF officials, Quito and Washington 2005.
[74] As one Ecuadorian onlooker put it, "Bob Traa was working really hard and Emanuel was trying to boycott everything."

with a copy to all the G8 Finance Ministers, asking for Traa to be dismissed. As the negotiations continued throughout 2002, the IMF team had increasingly serious reservations about Ecuador's political situation, and especially about Emanuel. The IMF team was unsettled by strange transactions around key dates and announcements, and the technical negotiations were unconvincing. Traa dug in his heels and requested details from Emanuel which Emanuel was unable or unwilling to give. The negotiations were eventually aborted.

Thus substantive issues produced problems of 'style' which harmed the personal and institutional relationship between Ecuador and the IMF. Twice, the IMF mission considered that agreement had been reached with the government negotiating team but it emerged that the government was divided. On the second occasion, the government's rejection of the IMF deal was communicated through the media mere days after the IMF thought it had reached agreement. Noboa's announcement on freezing electricity tariffs in April 2002 was also a surprise for the IMF. Then the relationship with the resident mission was damaged when Noboa's economic team attempted to negotiate with Washington directly instead of with the resident mission, as usual. As trust evaporated, the problems compounded. There was little confidence in the numbers produced by Emanuel—a major problem for the IMF, which bases all its discourse in figures. This compromised relations at the technician level as well. The IMF suspected Emanuel was lying to them on various subjects, and discovered that while he was in negotiations with the IMF he was also negotiating an oil loan with private bankers. This was never included in any of the financing items. Emanuel even allegedly hired Washington lobbyists to negotiate with the IMF and the US Congress. Rumours about corrupt practices under Emanuel circulated, further eroding trust in him.[75] Traa was mindful of the abundant inefficiencies and corruption in the Ecuadorian public sector, and saw these sectors as the best potential source of finance. Convinced Ecuador did not need IMF finance and would not use it wisely, it would have taken a particularly winning performance from any Minister of Economy to persuade Traa to advocate a programme within the IMF. Conversely, any hints of duplicity confirmed Traa's belief that Ecuador was not politically ready for an agreement.

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[75] Interviews, MEF, Central Bank and IMF officials, Washington and Quito 2005.

Emanuel's tenure at the MEF marked the low point of the IMF relationship over the five year period.[76] As one MEF official recalled, "It took us two years of intensive work with the IMF to get confidence in the figures back, for them to rely on the figures we gave them."[77] Eventually, Emanuel was accused of redirecting over $2 billion without going through proper budgetary channels, and a missing $300 million was never found. After Noboa fired several MEF officials, Emanuel quit.[78] In August 2002 a jail order was issued, and Emanuel fled to Panama. The state auditor reported that Emanuel had given $108 million to local governments in 2002 while charging the 2001 budget.[79]

The relationship remained mostly tense and mutually distrustful under Noboa's fifth and final Minister of Economy, Francisco Arosemena, who took over in June 2002 when Emanuel resigned. Among policymakers there are two readings of Arosemena's tenure: first, that Arosemena attempted to recoup the ground lost under Emanuel, but ran out of time to impose sufficient fiscal discipline; second, that the President became more active at the MEF after Emanuel's disastrous tenure, and continued spending with Arosemena.[80] There is some truth in both. Arosemena had fewer personality clashes with the IMF team, and the relationship improved somewhat, but not quickly enough for a realistic chance at an agreement. At the same time, Arosemena was a loyal friend of Noboa and failed to reign in his spending inclinations. A particularly controversial issue was Noboa's oil facility loan, opposed strongly by the Central Bank: the outgoing administration was selling six months' oil in advance which would otherwise finance the budget of the incoming Gutiérrez administration. Noboa took a personal interest in this loan and, judging by his heated arguments with Central Bankers who opposed it, was emotionally invested in the issue.[81]

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[76] Also see Euromoney Institutional Investor (2002).

[77] Moreover, the legacy lasted well after Emanuel left office. In late 2002, negotiations were temporarily derailed when authorities discovered $200 million had been spent without being accounted for under Emanuel (*Oil Daily* 2002a).

[78] The news was received well in the bond markets. Ecuador's spread over treasuries dropped to 1,382 basis points from 1,522 that day (Euromoney Institutional Investor 2002).

[79] AAA Flash (2002).

[80] Interviews, MEF and IMF officials, Quito and Washington 2005.

[81] Interviews, MEF and Central Bank officials, Quito 2005. One commented: "This was terrible in my opinion. How can you do that to a new government, spend their oil money before they arrive? This was the biggest argument we had with Noboa at the Central Bank. You couldn't do this. The new President was already elected."

Stylistic problems continued under Arosemena. In August, at a particularly delicate stage in negotiations, Noboa announced: "Ecuador is a sovereign country, and I cannot disrupt public order because of what the IMF wants", adding that he would not allow Ecuador to be "destabilised and thrown off balance" by the IMF as other countries had been.[82] Arosemena, who on appointment had promised to make an IMF deal his "first and foremost priority",[83] complained to the Ecuadorian media that the IMF was continually "moving the goalposts".[84] The closest the Ecuadorians came to an agreement in stage two was when Arosemena took a Letter of Intent to Washington in September 2002.[85] But even as he did so, Noboa made defiant proclamations to the Ecuadorian media: "Ecuador is a sovereign country which has its needs but it does not bow to anyone. For the good of all Ecuadorians I have to respect the definitive position of our country. We shall not go beyond that."[86] Prior to one IMF meeting in Washington, Arosemena announced to journalists, "In no way are we talking about submission or accepting impositions."[87] Noboa made similar declarations in support of Arosemena.[88]

It became increasingly unlikely an agreement would be reached under Noboa. Both sides had serious qualms. Arosemena was officially charged with signing an IMF agreement before August 2002, but the Ecuadorian economic team was internally divided. The Ecuadorian leadership were reluctant to commit to austerity measures in an election year, but recognised that financing would enable expansive spending during the campaign period. MEF technocrats who responded less to political considerations wanted the opposite: austerity measures and *less* access to overseas debt. Although the former Chief Economist of the Central Bank, Ramiro Galarza, was in favour of an IMF agreement as a means of ensuring tight fiscal management, he felt the timing was inopportune to achieve this goal:

> "We were in a meeting and the IMF said they were considering going into a standby sometime in September 2002. And I said 'I think it is

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[82] *Latin America Weekly Report* (2002d).
[83] Woodward (2002).
[84] Moss (2002a).
[85] *Xinhua General News Service* (2002).
[86] *BBC Monitoring Latin America* (2002).
[87] *Gazeta Mercantil Invest News* (2002).
[88] Noboa was said to be "clearly irritated", saying "I told the minister, take the last letter from Ecuador. If they accept it, fine, and if not, also—because I cannot lower the Ecuadorians' wages." *Latin America Weekly Report* (2002b).

> irresponsible to give us a standby now because this will only enhance our financing opportunities, and basically what we'll do is to expand expenditure the day after you give us the standby'. And obviously the minister (Arosemena) wanted to do that."[89]

The leadership was able to purge this element. Following this meeting Arosemena dismissed Galarza, who had been managing the relationship with the IMF.

On the IMF side, there was a default reluctance to negotiate or sign an agreement in the dying days of an administration.[90] This was not the sole determining factor—around the same time, Argentina negotiated an agreement just before its elections—but the IMF relationship was still recovering from Emanuel, and the IMF knew the MEF was divided. It was too close to the elections for any unpopular legislation to be even attempted, let alone passed. The IMF negotiators were wary of attempts to obtain a first tranche only to have it finance expansionary, unapproved spending by an administration which would not have to face the consequences. They began demanding austerity in prior actions.

The rift in the relationship in 2002 was due to both style and substance; or, to put it another way, both to attributes perceived by the IMF as portending later intransigence, and to refusals to commit to specific reforms. The stylistic problems eroded the IMF's confidence in the Ecuadorian team and institutions. Corruption scandals and chronically poor communication undermined the Ecuadorian negotiators' credibility, and the IMF negotiators felt criticised and duped.

Because of this, the IMF was much less amenable to allowing loopholes to creep in when it came to the biggest substantive issue of the negotiations. The Fiscal Responsibility and Transparency Act (FRTA) was a prior action for the embryonic agreement. The legislation, explored in detail in Chapter Four, underpinned the fiscal discipline of later administrations and was crucial to the development of the IMF relationship under Gutiérrez. Ecuador had been on the verge of securing an agreement when Congress amended the legislation. Although it passed, it was quite different to the Act the IMF wanted.

The IMF's major concern with the FRTA was the loose regulation of the 90% of the oil fund the legislation nominally assigned to repaying debt (the other 10% was

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[89] Interview, 7 April 2005, 12pm, Quito.
[90] Dawson (2003).

for health and education). Of this 90% the IMF predicted the 20% allocated for 'emergencies' would be spent ad hoc, and the remaining 70% would buy back domestic debt. This would pay back no external debt at all (and perhaps even finance new debt). The IMF wanted 100% (not 70%) to be used for paying down debt, and for that 100% to be used only for foreign debt, rather than domestic debt.[91] Media reported that the IMF had been "angered by the apparent looseness of the authorities' attitude to macroeconomic management".[92] Given the problems of credibility and trust, it is understandable that the IMF feared a future MEF and/or Presidency would avail themselves of loopholes. The IMF already thought Noboa's fiscal policies were 'excessively loose'.[93] When the IMF did not obtain the specificity it wanted in the FTRA, it could not trust to informal controls and thus pulled out altogether.

Finally, let us revisit the relationship between weakness and easy agreement. A simple model would explain the strict 2000 agreement in terms of Ecuador's desperation for finance (*if* weakness *then* easy agreement). However, this would not account for non-agreement in stage two. The only way to disprove a conditional premise of the form *If x then y* is to find an instance of *x* without *y*. It seems stage two provides this: weakness without easy agreement. Ecuador's economic situation during the tenure of Emanuel and Arosemena was not rosy. In the first quarter of 2002 the oil sector was predicted to grow by 4.8% but instead contracted by 2.4%; manufacturing contracted by 2.5%; and the post-crisis construction boom which increased tax receipts was clearly over (growth slowing from 15.2% in 2001 to 2.3%). Overall, the economy contracted by 0.9% in the first quarter of 2002, devastating the official prediction of 4.5% annual growth. The Economic Commission for Latin America and the Caribbean accordingly revised their prediction in August 2002 to just 2.5% growth; the Pichincha Colegio de Economistas projected a 2% *contraction.*[94] The Colegio's trade prediction was even more worrisome: $1.5 billion deficit, as against a $150 million surplus in 2001—even just before the crisis, in 1999, the trade deficit had been only $900 million.[95] International reserves were at their lowest point for ten years (see figure 2.1). Scheduled debt service and amortisation payments for the remainder of the year were $830 million, of which the fiscal surplus would provide

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[91] In addition, the IMF wanted revenues from the old oil pipeline as well as the new one to go into the fund.
[92] Woodward (2002).
[93] *AFX News Limited* (2002).
[94] *Latin America Weekly Report* (2002a).
[95] *Ibid.*

only $505 million.[96] Ecuador was still feeling the financing restrictions associated with the Brady bond default, and by July 2002 Ecuador's bond yields were barely any tighter than the day after the Global Bonds were launched.[97] By August 2002 there was a financing gap of $700 million, the current account was almost empty, and teachers and doctors (two traditionally militant sectors) had been unpaid for three months.[98]

What is more, virtually all of this was clear at the time. Noboa's administration knew it faced a shortfall of almost $1 billion in the 2002 budget and a low oil price.[99] As time went on, the contracting economy, the worsening finance gap, and the tight bond yields became clear. "Ecuador is headed into an [economic] disaster again," one Wall Street analyst said.[100] To finance the budget and meet the scheduled debt payments, Ecuador needed an IMF agreement. The initial tranche would have been $50 million, with other funding conditional on an IMF arrangement: $150 million from the Andean Development Corporation (ADC), $50 million from the Inter-American Development Bank (IDB) and $30 million from the World Bank.[101] In the slightly longer term, Ecuador would have received a $1.09 billion loan from the IDB, World Bank and ADC,[102] and potentially Paris Club debt relief.[103]

Despite these economic problems, Noboa, Emanuel and Arosemena did not perceive a fiscal crisis resolvable only by an IMF deal. Instead of reaching an agreement, the Noboa administration imposed liabilities on Gutiérrez' term. Firstly, the Noboa administration set an optimistic budget, allowing Noboa to meet political commitments while adhering to balanced budget legislation.[104] Secondly, Noboa's administration attempted to sell future oil production. That is, the oil that would otherwise provide income for the incoming (Gutiérrez) administration would instead be sold in advance to finance Noboa's spending. This 'oil facility loan' was strenuously opposed by the Central Bank. Thirdly, the Noboa administration was later

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[96] *EIU Crossborder Monitor* (2002).
[97] Ecuador's spreads were still 1300bp over treasuries, at the bottom of the emerging market table (Euromoney Institutional Investor 2002).
[98] Moss (2002b).
[99] $18-20—for comparison, it was $30-35 in January 2003.
[100] *Oil Daily* (2002). Another commentator concluded that, "Given dollarisation and the government's limited financing capabilities, a new agreement with the Fund is essential."
[101] *EIU Crossborder Monitor* (2002).
[102] *Xinhua General News Service* (2002).
[103] Woodward (2002).
[104] Oil production was overestimated with little justification and the oil price was set at $19, even though $15 was forecast. See Kerr (2002b).

found to have deceived its successor when presenting its initial economic review.[105] Noboa's administration left arrears of $722 million, owed to Ecuadorian and foreign banks, the Paris Club, and public servants, and upcoming obligations of $1.25 billion to cover wage increases, amortisation and interest, and the deficit.[106] The IMF did not approve of Noboa's optimistic budget and certainly not of the practice of selling oil ahead of time to finance current spending.

This section has aimed to explain why there was no agreement in stage two by examining the preferences, powers and constraints on political leadership, MEF technocrats and the IMF. By stage two, the IMF team had learned from their experience in stage one and were much less willing to sign an empty agreement only to grant waivers later. Instead, the emphasis this time was on prior actions, especially the FRTA. Lack of trust in the economic leadership made this strategy even more important. For their part, the Ecuadorians seem to have seen the earlier set of waivers as specific to a crisis context, and did not expect to be able to ignore conditions with impunity a second time. As we will see later, they devised other means of watering down the FRTA legislation and circumventing it once passed: parallel legislation, secretive practices and obfuscation of numbers (see Chapter Four).

This section has showed that the personal abilities and choices of the Ecuadorian leadership were important, but also that these must be understood within institutional constraints. Despite falling economic performance, during 2002 there was an apparent equilibrium of power as both parties were willing to walk away from the table. This was because of decision-makers' interpretation of the depth of a crisis and the alternative options, and because of the incentives they faced as a result of their political aspirations and obligations. Emanuel and Noboa both wanted to enhance their electoral prospects. Noboa was keen to stay away from the IMF and to increase spending, and Emanuel wanted to satisfy the demands of his two constituencies: elite political business connections, and the poor Ecuadorians he would need to appeal to as a candidate. Noboa's later ministers repeatedly travelled to Washington to negotiate an agreement but were simultaneously outspoken in criticising the IMF and unwilling to push domestically to obtain an agreement. In the end, they were unable and unwilling to provide the extra security needed to compensate for lost credibility.

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[105] *Financial Times* (2002).
[106] Solano (2002).

The IMF preferred no agreement to false agreement, and aborted negotiation when Ecuador's lack of commitment became apparent.

Stage Three, January 2003 to May 2004

Noboa's replacement Lucio Gutiérrez took office on 15 January, 2003 and secured a $205 million standby arrangement within less than a month—a record.[107] This allowed Ecuador to obtain money from the other multilateral credit organisations (the World Bank, IDB and ADC), renegotiate part of its debt with the Paris Club, and begin to improve its reputation in international markets. Gutiérrez could agree so quickly because his team was credible and agreed *ex ante* with the IMF on virtually every point. In this section, I show that the most important negotiations took place within the executive, not between the IMF and the executive. The winners of this internal battle then shut out the 'losers'. MEF technocrats had autonomy over the design of the reform agenda and did not need to engage with other institutions or with civil society. The economic leadership was keen to sign before anyone knew what was happening, and the basic technical analysis had been done during 2002. As a result, agreement was easy. The IMF team saw the pliability and manifest commitment of the Ecuadorian economic team as a golden opportunity to have impact in multiple sectors of the economy. However, the outcomes of the agreement were dismal. This section explains how the autonomous economic team was constructed and why it eventually undermined implementation.

Gutiérrez was much more committed to an IMF programme than Noboa. Immediately after being elected, but before taking office, Gutiérrez announced that he was open to an IMF agreement, and sent his administration-in-waiting to Washington for informal negotiations. The Minister of Economy, Mauricio Pozo, and the President of the Central Bank, Mauricio Yépez, began working with him. The IMF received Gutiérrez positively and officials on both sides were optimistic. While officials in Noboa's administration recalled Noboa's lack of commitment to an agreement, those in the Gutiérrez administration spoke of Gutiérrez' "absolute commitment" and "clear sense of necessity".

This attitude was surprising, as Gutiérrez had been elected as a left-wing champion of the poor, campaigning against neoliberal reform, especially privatisation,

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[107] Roldós Aguilera (2003).

and promising not to increase the price of electricity, telephone service, public transport, or LPG.[108] At the beginning of the Gutiérrez administration the markets and the IMF were pleasantly surprised "to see that he was not another Hugo Chávez".[109] Ecuadorian political commentators tried to explain Gutiérrez' change of heart in various ways: as arising from "a double personality, one as candidate and another as president"; as a function of his political inexperience; as a function of his political savvy; due to his "spontaneous" personality; to his "chameleon" personality; and to a lack of ideology, allowing him to be—in the words of one interviewee—"a very practical man".[110] One school of thought saw Gutiérrez as a pawn of international financiers, either fooled or paid off; others saw him as duped by persuasive Ecuadorian technocrats. Technocrats themselves generally account for his conversion as due to his learning about the poor state of the economy.

A partial explanation stems from his institutional context. Because Gutiérrez lacked private sector advice on his campaign team, he approached the Central Bank for advice on Ecuador's economic situation. After the election it was a natural progression to ask the Central Bank to help design Gutiérrez' economic programme. Under Gutiérrez, the MEF and the Central Bank were aligned; Ministers Pozo and Yépez had worked in both institutions (and the IMF) and had an excellent working relationship. Perceiving an impending crisis, Pozo was convinced an IMF agreement was necessary. The incoming administration had arrived to serious problems of macroeconomic stability and a financing gap of $2 billion. Pozo inherited public sector arrears of $150 million and scheduled debt payments of $500 million in the first quarter, amid falling oil prices. He felt his only option was to impose austerity via an IMF agreement, and to get funds from the IMF, World Bank, IDB and ADC. Pozo devoted much of his time to the relationship with the President, persuading him the reforms and austerity were necessary. He often found himself, "the advisor during the day", undermined by "advisors during the night" but after many months of speaking to him almost every day, according to Pozo, Gutiérrez became "completely convinced".[111]

On the IMF side, the confidence which had been lacking under Noboa and Emanuel was regained. This was for three reasons. Firstly, Gutiérrez' economic team

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[108] *Latin America Regional Reports* (2002), *Financial Times* (2002).
[109] Urgiles (2004b).
[110] Segovia (2003).
[111] Interview, Mauricio Pozo, 21 March 2005, 4pm, Quito.

was known and trusted. Whereas Noboa's appointment of Emanuel was blatantly political (the keystone of a congressional deal with the PRE), Gutiérrez appointed technocrats. Pozo naturally appealed to the IMF: a US-trained commercial banker and private consultant known to hold orthodox economic views [112] and described in media reports as "clearheaded and tight-fisted".[113] Guillermo Lasso, Gutiérrez' personal advisor on finance and economics, was a private banker whose orthodox economic views were well known.[114] Lasso was a key player in Gutiérrez' ideological makeover, organising Gutiérrez' tour of US-based financiers to convince them of his orthodoxy.[115] In addition, the way that non-orthodox elements within the MEF team were dealt with—swift and public exclusion, as we shall see in the next section—helped confirm that the MEF leadership were neoliberal 'true believers'. Secondly, Gutiérrez' team signalled well before taking office that they would co-operate with the IMF. Even before he took up his post, Pozo gave interviews as the incoming Minister of Economy explaining the need for an "urgent and orthodox economic programme which erases concerns about moratoriums on the debt" and revealing the top-down management style which would characterise his Ministry ("as long as I head this ministry, this matter will be addressed in this way").[116] Within a week of taking office, Gutiérrez issued an austerity decree which froze regular civil servant wages, cut overtime allowances, reduced his own salary by 20% and other high officials' by 10%, and removed several fringe benefits. Thirdly, during the negotiations the MEF team repeatedly offered more than the IMF asked for and distanced itself from the previous administration's "slippages" in the Letter of Intent.[117] The makeover was effective; the Gutiérrez government was praised in IMF documents, press conferences and press releases for its "courageous" attitude and "bold" and "ambitious" measures and a distinction was repeatedly drawn between the Noboa and Gutiérrez administrations.[118]

Pozo enjoyed the support of Gutiérrez both inside and outside the Cabinet, giving him the ability to run negotiations as he wished. What he wished was to take

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[112] See, for example, *EIU RiskWire* (2003b).
[113] Barham (2004). The markets responded to the naming of Pozo as MEF with a lowering of Ecuador's country risk (Urgiles 2004a:36).
[114] Hayden (2000).
[115] *BBC Monitoring International Reports* (2003b).
[116] *Ibid.*
[117] Government of Ecuador (2003a).
[118] See, for example, IMF (2003a,2003c).

absolute charge of the team himself. He did this by centralising negotiations within the MEF, and then purging the MEF negotiating team of heterogeneous elements. The most significant case of 'purging' was the dismissal of Pachakutik, a radical indigenous party. This deserves a detailed treatment, as it is both an important episode in itself, and also reveals the attitude prevailing in Pozo's MEF, privileging fast agreement over incorporating input from civil society or other state institutions. With the MEF in sole charge of negotiation, the presence of Pachakutik represented the last chance to heterogenise the negotiation team and to generate a politically-savvy reform agenda. Instead, Pozo made his team autonomous and ideologically pure.

Gutiérrez began his administration supported by a PSP-Pachakutik coalition. It was a marriage of convenience: during the campaign, Pachakutik gave the PSP social legitimacy and mass support, and the PSP offered Gutiérrez as a credible presidential candidate. [119] The bargain was probably in the PSP's favour, as Pachakutik's agreement represented a hasty internal compromise after their attempts to select their own presidential candidate nearly split the party.[120] After the election, Pachakutik lost a great deal of its leverage over the PSP.

Pachakutik was not initially opposed to approaching the IMF. Before taking office, Pachakutik and the PSP planned for the first 100 days of governance, inviting participation from diverse (left-wing) sectors including universities, think tanks, social movements, and activists organised into various committees. One of these, the Macroeconomic Committee, incorporating several prominent left-wing economists (but not Pozo, Lasso or Yépez), developed a 'countercyclical plan' which they decided to bring to the IMF as a 'consensus letter of intent'.[121]

Initially, therefore, all agreed an Ecuadorian team should approach the IMF. But Pachakutik was included in the negotiations only at the IMF's insistence.[122] Bob Traa, IMF mission chief, was keen on transparency in negotiations and felt Pachakutik would only appreciate the complexity of the problems if they were

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[119] Interviews, Conaie and Pachakutik members, Quito, June 2003 and April 2005.
[120] Klinkicht (2003).
[121] Pachakutik were conscious of their potential role in breaking the cycle of uncompleted IMF reforms: "We could propose it to the IMF, so that it could be a real promise, not just a Letter of 'Intent', and then once we've signed we don't comply with it, like all the other Letters of Intent Ecuador has had." Interview, Fernando Buendía, 18 March 2005, 4pm, Quito. For the proposals which came out of this macroeconomic committee, see *El Comercio* (2003a).
[122] As one participant put it, "The tradition is to ignore the Indians."

involved in finding solutions. According to participants, Ecuadorians on all sides were surprised at the IMF's insistence that Pachakutik take part.

During the unofficial IMF negotiations before the new government took office, the co-ordinator of the PSP-Pachakutik Macroeconomic Committee, Fernando Buendía, travelled to Washington on one occasion as part of the government economic team. Buendía saw it as a golden opportunity to advance the heterodox agenda they had developed. There were thus two discourses represented in the negotiations of January 2003: Gutiérrez' team wanted to deconstruct the state apparatus, while Pachakutik wanted to strengthen it (in their words, to 're-statise' the state).[123] To Buendía's surprise (but probably not to anyone else's), Pachakutik's proposals suffered what he calls a lack of "prestige" and "recognition" throughout the negotiations. Even though some measures fit well with Gutiérrez' anti-corruption platform, the neoliberal MEF team was unenthusiastic. When it came to negotiating, according to Buendía, "It was obvious that there was a complete absence of will to achieve reconciliation." Pozo was keen to establish himself as the leader and had a strong ideological commitment to neoliberal reforms. For him, any attention given to Pachakutik was simply wasted time.[124]

Because Pozo and the IMF basically agreed, the locus of negotiation was within the Ecuadorian team: an asymmetric battle between Pozo, Gutiérrez, the MEF and IMF technocrats on one side and Pachakutik on the other. Pozo was clearly negotiating from a much stronger position. He was the official leader of the team, his ideology backed by the IMF, and with the authority of the senior coalition party and the President. As Pozo was unwilling to concede anything, Buendía perceived much more openness to Pachakutik's proposals from the IMF, even saying that "at one point, I perceived a certain predisposition to our proposals."[125] He particularly gained heart from the presence of Bob Traa, perceiving that a Dutch negotiator might be more sympathetic to statist policies. However, although Buendía saw the IMF as a neutral arbiter,[126] it seems unlikely IMF officials ever seriously considered the Pachakutik proposals, which were based in a rejection of much of the Washington consensus.

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[123] Interviews, MEF and Pachakutik representatives, March and April 2005, Quito.

[124] Interview, Fernando Buendía: "We wanted to agree, we had a predisposition to agree. It was a government that wasn't exactly what we wanted, but there were some aspects that were democratic and progressive. But Pozo wasn't having any of it."

[125] Indeed, there were some agreements on issues such as tax evasion.

[126] "And so they posed these things, and I posed the other things, and the position of the IMF was to listen. Fullstop."

Knowing the MEF leaders opposed Pachakutik's proposals and would win the internal battle, the IMF had nothing to lose by listening politely.

The Letter of Intent which emerged from this process contained many of the same reforms which had failed in 2000. The government announced it would reform social security and customs, the civil service wage structure and the oil sector, and that it would reduce domestic fuel subsidies and raise electricity tariffs, while placing the electricity and telecommunications companies under international private management. The key change between the two agreements is that the structural reforms in the 2003 agreement were much more explicit than in 2000. Several reforms were expressed as prior actions, including the first steps of the electricity, telecommunications and customs reforms, and a wage freeze. Elsewhere, clear performance criteria set out reforms for customs, tax, the civil service, and the oil sector. Moreover, while the prior actions were all controllable by the executive, there were performance criteria relating to outcomes clearly not under executive control.[127]

The social sectors who elected Gutiérrez assumed they would contribute to his economic policies. But Gutiérrez returned from Washington with the Letter of Intent already signed. As Pozo said with relish, "When they were trying to understand what had happened, we had already signed. They were saying, 'Where are we?'... but it was too late!"[128] Following this meeting, Pozo shut Pachakutik out of the negotiations entirely. No more Pachakutik representatives attended IMF meetings, even though they remained part of the governing coalition for six months. Members of Pachakutik did work as advisors to the MEF, fulfilling a stipulation of the coalition negotiations, but had no real policy impact.[129] Even this was aimed at 'educating' Pachakutik members rather than incorporating their input; Pozo felt if Pachakutik saw the economic problems, they would become advocates of his solutions. To Pozo's disappointment, "they were not open-minded enough to understand what changes were needed".[130] Moreover, although Pachakutik hoped this role would give them access to information, they found themselves shut out of information loops as well as

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[127] For example, '*Passage* of the law for public sector wage unification and civil service reform'. (Government of Ecuador 2003a, italics added).
[128] Interview, 21 March 2005, 4pm, Quito.
[129] Pachakutik developed several proposals, including one to increase the electricity tariff to cross-subsidise LPG which was presented to Gutiérrez, delegated to Pozo, and ignored.
[130] Interview, 21 March 2005, 4pm, Quito.

decision-making processes.[131] Pachakutik publicly rejected the IMF programme, setting Gutiérrez a 30-day deadline to satisfy a list of demands including abandoning the programme, removing Pozo and his team from office, granting more indigenous representation, declaring future IMF deals "unconstitutional", and several demands relating to specific IMF reforms. Through the media, Gutiérrez refused to become "a hostage of Pachakutik."[132] From then on, Pachakutik and the MEF fought constantly and it was clear the governing alliance could not last.[133] After six months, it collapsed.

When asked about the role of Pachakutik in the negotiations or the MEF, most Ecuadorian officials seemed surprised at the question. Many responded with a general answer about consultations with all parties in Congress. However, for six months Pachakutik was not merely 'a party in Congress', but part of the government. Despite this, top officials barely recall their presence. Many interviewees could not recall Pachakutik during the negotiations, or only after prompting.[134] Recollection of policy proposals was even hazier. One MEF official recalled Pachakutik's criticisms as only beginning after leaving government. Even when asked specifically whether Pachakutik proposed alternative policies, interviewees quickly reverted to the need to educate Pachakutik.[135] Where Pachakutik is remembered at all, their involvement is seen as ignorant, ideological or even dishonest. Some officials explained their exclusion as resulting from their technical inexperience,[136] reflected in their economic proposals ("thinking in the sky", as Pozo put it). Others saw them as reflexive ideologues: "They were opposed to many of the reforms, for instance the gas subsidy removal. It is absurd. Actually the government could give more money to help them… I don't know why they don't understand that. They don't want to accept that."[137] Many interviewees commented that the individuals sent from Pachakutik "learned a lot" and secretly agreed on the need for reform, but that in public they could not

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[131] Even though they were part of the government, Pachakutik was uninvolved in the revision of the budget. Buendía says, "Four people wrote the budget, between four walls… We knew nothing at this point. They told us nothing". Interview, 18 March 2005, 4pm, Quito.

[132] *Latin America Weekly Report* (2003).

[133] An evaluation of the first month of Pachakutik's participation in the government, complained, "The presence of Pachakutik, which was a crucial force in the government's triumph, has been marginal and little-respected within the government" (Segovia 2003:35).

[134] This comment, from an MEF official, was typical: "I can't really remember but I would say that they were not in the mainstream, against the current and so they had no say."

[135] For example, one Central Bank official said, "Pachakutik didn't participate too much. But the government consulted them, tried to convince them that it was best for them, for the country I mean."

[136] "They don't have many people who are well-prepared in economics. Not many of them were involved because they didn't have the people."

[137] Similarly, another MEF official commented, "Pachakutik couldn't really argue against what needed to be done, it was obvious that it needed to be done."

express this as it would endanger the Pachakutik 'brand' and perhaps their personal political fortunes.[138] Thus the least charitable version of events was to call Pachakutik 'irrational'; the most charitable, and most common, version was *They agree with us really, they just have to pretend to be irrational.*

Pachakutik's attempts to formulate alternative statist proposals were probably futile, as they were irreconcilable with Pozo's neoliberal orthodoxy. However, there were areas of potential agreement overlooked in Pozo's desire to eliminate internal opposition. For example, the subsidy on LPG—somewhat of an IMF obsession—was ripe for collaboration. For over a decade Pachakutik's support base has vetoed eliminating the subsidy. As Chapter Three will show, their opposition rests on a rational mistrust of government to redistribute the proceeds in a pro-poor manner. Pachakutik's position inside the governing coalition was a golden opportunity to transform this mistrust into support for a pro-poor agenda of eliminating regressive subsidies and redistributing the subsidy to improve the quality of social spending.

The first months of 2003 were a unique opportunity to achieve this. Pachakutik had become part of the governing coalition in a time of tremendous euphoria and optimism within the indigenous movement. After centuries of marginalisation, Ecuador's indigenous were finally in charge. Moreover, in a political system in which virtually all players and parties are discredited, Pachakutik's was the most 'pure' brand, owing to their historical isolation; until 1996, Pachakutik advocated a boycott of electoral politics altogether. Pachakutik were thus the best candidates to manage a political strategy which depends on poor people's trust in the state. Had Pachakutik been recruited to manage the elimination of the subsidy, it may have been possible to persuade those who traditionally march against it that it was in fact in their interests. There was also potential for collaboration with the IMF against the MEF team members who would exclude them; in fact it was the IMF which insisted on including increasing the Solidarity Bond as a prior action for the first review, to ensure the benefits of eliminating fuel subsidies were passed to the poor.

Instead, as we have seen, Pachakutik was purposely marginalised by MEF leadership. This brought short-term gains, but in the long term undermined the reforms in three ways. Firstly, ignoring the potential input of Pachakutik produced an ambitious but politically uninformed reform agenda, with implications which we will

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[138] For example, "For them it's more of an ideological thing to be opposed to the IMF. And they had to defend their turf and be the leaders of that constituency."

see in the next chapter. The IMF found they did not have to 'convince' the Ecuadorian side of the necessity of reform, and that they even agreed on most sequencing. As one official said:

> "In 2003, Pozo and his team entered the room and said, we want to do this, this, this, this, and this. And the IMF said, well, I guess... if you think you can do it... And perhaps they should have said, "No, that's overambitious". But the IMF is used to a bargaining situation; they are used to negotiating to get more out of a country. With Pozo and his team they didn't have to."

Secondly, Pachakutik is a political party which reflects, but also commands, genuine mass participation. It is capable of mobilising both popular support and opposition. In sidelining Pachakutik, the MEF could move quickly to conclude the agreement and formulate the budget, but lost an ally for the implementation stage. Thirdly, the collapse of the alliance with Pachakutik and the need to gain the support of other parties clearly affected the government's ability to implement the reform agenda, especially those items requiring legislative approval.

Pozo systematically avoided and sidelined all interests he knew would disagree with him. To avoid debate slowing reform plans, Pozo did not seek approval of Cabinet, or even inform Cabinet before his programme was announced.[139] Pozo was sometimes the only IMF champion ("It was difficult, the first six months. Sometimes I was against the whole cabinet"). Within the MEF, dissenting voices were eliminated and debate allowed only within a neoliberal paradigm. Pozo said, "It was one of the main conditions I put on the table before I accepted [the position of Minister]. I am the boss, I am the leader and you can put other people in other public functions but they need to follow my objectives and my North." Pozo insisted on controlling appointments within his economic administration. Additionally, Pozo controlled the 'message', not allowing any other members of his economic team to interact with the media (unlike his successor, Yépez).

This stage, like the previous one, reveals the importance of autonomy and ideology. Where Noboa's administration had lacked commitment and credibility, constantly fought with the Central Bank and endued a year of fruitless negotiations,

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[139] Interview, Mauricio Pozo, 21 March 2005, 4pm, Quito.

Gutiérrez responded to the same macroeconomic situation with a deep desire for an IMF agreement. Neoliberal Pozo increased his autonomy by eliminating internal opposition, with the result that the IMF team and a streamlined, orthodox MEF-Central Bank team developed an ambitious reform agenda quickly and harmoniously. In doing so, however, he undermined implementation by helping to turn a potential key ally into an entrenched opponent.

Stage Four, June 2004 to April 2005

The new standby was intended to run from February 2003 to March 2004. However, it was ended in August 2003 after the first review, due to failure to implement the structural reforms. As one official recalled, "Things escaped from us. Pozo thought it would be very easy to do the things he proposed... But then he hit the Ecuadorian reality!" MEF and IMF officials now agree the programme was "very ambitious", with "too many structural reforms", "covering too many themes", "too diverse".[140] In contrast, the fiscal measures were relatively successful. Pozo managed to lower the unpaid fiscal accounts from $700 million to $280 million,[141] the current account vastly improved by 2004 and stood at only $32 million deficit, and the trade balance was positive (though driven by oil).[142] Primary and global surpluses and economic growth were high, and inflation was under 2%. These positive fiscal results allowed Ecuador to walk away from the table—and the failure to structurally reform convinced everyone another agreement would be pointless.

In this stage, Ecuador's 'strength' allowed for non-agreement (in line with the 'crisis'/'weakness' model). While Pozo had tried for an IMF deal, the new Minister Mauricio Yépez decided he could fulfil the twin goals of financing and catalysing reform better without the IMF. This section shows how the availability of domestic and foreign alternatives, coupled with Yépez' philosophy of avoiding the IMF, allowed Ecuador to walk away from the table. Yépez and Pozo had the same economic constraints but used different strategies to achieve their goals.

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[140] Interviews, MEF, Central Bank and IMF officials, Quito and Washington 2005. Speaking in hindsight, Pozo disagreed, "Nothing is worse than if you do not try. We knew it was difficult. That's also why the economic programme tried to reach many objectives. At least we could reach something in the middle."

[141] Gestión (2004c).

[142] Figures shown to me by Mauricio Pareja, GM of Central Bank, in Central Bank offices, 22 March 2005, 9.45am.

Once the futility of the 2003 programme became clear, there was a mutual, amicable decision to end it prematurely. The first review had required 13 waivers, almost a record. At the IMF there had been an internal battle. Several officials, including members of the IMF team in Ecuador, thought it was inappropriate to proceed. However, since the money involved was relatively small (and, according to some individuals involved, because the US State Department wanted Ecuador stable to help with Plan Colombia), the balance favoured renewal. By the second review there was little argument against cancelling the programme. It was clear the reforms would not be implemented. As time passed, oil prices rose and fiscal performance improved, the alternatives to IMF funding had increased. Yépez inherited a more stable situation and could focus on increasing income rather than cutting spending.

He did this in two parts. The first involved Feirep, the oil fund originally meant to repurchase debt. Yépez used Feirep resources to buy bonds held by the state social security fund, and included these as a source of financing in the 2004 budget. Yépez' second step was to develop an arrangement so Ecuador could access multilateral finance without a formal IMF agreement. The IMF provides little finance directly, but it catalyses other funds. By 2004, Ecuador had become a net amortiser of debt, but the multilaterals wanted to maintain their exposure to Ecuador and therefore to continue lending. [143] These loans have a condition that the macroeconomic framework be adequate to receive programme funding, and in Ecuador's case—because of low confidence—this is usually met by an IMF standby. Yépez negotiated an 'intensified surveillance' arrangement instead. This unusual arrangement involves no formal agreement, but an IMF-style programme initiated by the government, with quarterly targets.[144] The key element is frequent monitoring by an IMF mission in an Article IV-style review which comments on planned reforms and their implementation, and feeds into other funders' decision-making processes. This unlocked funding from the World Bank and the IDB by assuring them Ecuador's policies were macroeconomically sound. Ecuador kept receiving technical support from the IMF.[145]

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[143] Interviews, World Bank, IMF, Central Bank and MEF officials, Quito and Washington 2005.
[144] The only two other countries which have had this arrangement are Nigeria and Jamaica. It seems likely that Jamaica's example particularly occurred to new mission chief Trevor Alleyne, who is Jamaican.
[145] Interviews, World Bank, IMF, Central Bank and MEF officials, Quito and Washington 2005.

The new strategy was not determined entirely by political and economic constraints; Yépez did have other options. This can be seen by comparing the beginning of Yépez' term as Minister of Economy with the end of Pozo's. Pozo faced heavy initial economic constraints, but handed a much-improved fiscal situation to Yépez. Despite this, until the last days of his tenure, Pozo had still been negotiating with the IMF for a new standby. The IMF was reluctant, thinking the weak executive could not get reforms through Congress. But in February 2004 a new IMF agreement was widely expected by the markets, and Ecuador's country risk was at its lowest point since the crisis.[146] In March 2004, *Gestión* reported that Pozo had gone to Washington to study two options: a one-year standby extension, or a new Letter of Intent, leading to a standby for an undecided amount. *Gestión* was fairly optimistic one of these options would come to pass.[147] When new mission chief Trevor Alleyne took over in April 2004, they had still been discussing options. Within the IMF the frontrunner for some time was a formal staff monitoring programme (like a small-scale standby, with some structural reform obligations). In May 2004, an IMF team visited Quito to prepare for negotiations on a new arrangement. Even in June, analysts at Credit Suisse First Boston put the chances of an IMF programme in the third quarter of 2004 at 50:50.[148] Pozo left declaring an IMF deal was likely before August 2004.

Faced with the same circumstances and reform goals, Yépez concluded he did *not* need to go to the IMF. Pozo had thought IMF conditionality was a useful straitjacket, enabling him to push the reforms he wanted.[149] Yépez disagreed—after all, Pozo's attempts to reform had failed. Worse, the detailed IMF conditionality with specified dates had made the government vulnerable to congressional blackmail. The feeling grew in the MEF that reform would be easier if it was seen as Ecuadorian, albeit IMF-approved, and Yépez decided to attempt reforms outside an IMF agreement.[150]

Yépez was certainly not trying to avoid reform. He rebranded the economic programme, referring to it as the President's programme and not the MEF's, and

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[146] Urgiles (2004b:38).
[147] *Gestión* (2004d).
[148] Barham (2004).
[149] Interview, Mauricio Pozo, 21 March 2005, 4pm, Quito: "We need more pressure from abroad, and and that is why my opinion was to have the push of the IMF. And also so that I could say, it's not my fault, it's theirs!"
[150] Interview, Mauricio Yépez, 7 April 2005, 11am, Quito.

removing references to the IMF. In March 2005, the government sent a package of reforms to the Congress (The Economic Rationalisation of the State Bill, nicknamed *Ley Topo*) under the 'intensified surveillance' arrangement. The *Ley Topo* contained all the MEF's top priorities and bore a close resemblance to the 2003 Letter of Intent.[151] In some areas it went even further.[152]

However, to the MEF and IMF's dismay, Yépez' approach was no more successful than Pozo's. Attempts to avoid invoking the IMF did not significantly affect the passage of the *Ley Topo*, or any other major structural reforms. In early April 2005 the *Ley Topo* failed overwhelmingly in Congress, with 68 of the 71 legislators present voting against it. Less than two weeks later, on 20 April 2005, Gutiérrez was ousted by Congress amid an uprising against him. Only one IMF 'intensified surveillance' review ever occurred.

The *Ley Topo* failed for two reasons. Firstly, it was always a long shot. Several powerful, well-organised, experienced groups oppose the reforms (see Chapter Three). But the opposition to these proposals is not normally *so* overwhelming, and 96% unity in Congress on any issue is rare. The *Ley Topo* failed so conclusively because of bad timing. Gutiérrez' popularity had gradually decreased ever since his election, but particularly after December 2004 when he engineered the dissolution of the Supreme Court. In April 2004, opposition gathered pace. At this point there were several, sometimes overlapping, coalitions of congressional parties vying to create a majority to install their favoured candidate as a replacement Attorney-General. In a series of escalations, parties within Congress battled to regain control of the court system; radical sectors struck and demonstrated; Gutiérrez offered a heavy-handed response, repressing the media and tear-gassing the Congress; and civil society began mobilising en masse to protest first the blatant politicisation of the judiciary and, later, Gutiérrez' authoritarian response itself. Gutiérrez' response to public protest merely encouraged further protest, particularly in Quito, as citizens defied his suspension of the rights of free assembly and free speech to gather in parks and street corners and express opposition to his presidency. Sensing that the public would support their dismissal of Gutiérrez—and amid credible rumours that Gutiérrez might declare himself a military dictator—once assured of high level military support, Congress

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[151] Yépez' three priorities in April 2005 were oil reforms, electricity, social security. Interview, 7 April 2005, 11am, Quito.

[152] The *Ley Topo* was like the '2004 agreement' which never was. It contained far-reaching reforms to social security, barely mentioned in the 2003 Letter of Intent.

used the least objectionable constitutional provision available and declared that Gutiérrez had 'abandoned his post'. He was replaced by his Vice-President Alfredo Palacio.

In this context, it was inconceivable that any government legislation would pass in Congress. The *Ley Topo* was introduced just days before Gutiérrez fell. When sent to Congress, the government had controlled a slight majority as a result of some short-term political deals. However, this majority was highly unstable and broke up the week before the *Ley Topo*'s first vote in Congress. Then, while the *Ley Topo* was considered, Congress was preoccupied with constructing a majority to dissolve Gutiérrez' Supreme Court and replace it with a new system. However, because of congressional fragmentation, there were numerous proposals with various ways of selecting judges. Each day closed with no fewer than five party blocs; at one point, there were twelve distinct proposals. Each bloc had the same two goals: firstly, to be seen to lead the defeat of Gutiérrez' Supreme Court, which was publicly reviled, and secondly, to gain as much influence as possible in whatever system replaced it. For each bloc, though maintaining Gutiérrez was undesirable, it was preferable to supporting another bloc which would then reap these twin benefits. Congress was united in opposition to Gutiérrez, but divided in terms of positive proposals. It is largely for this reason that Gutiérrez managed to stay in power at all in his last weeks (the ambiguous position of the military also helped). During these weeks, public frustration mounted at what was seen as congressional incompetence to translate their opposition into action, and the reputational risk of being seen to support the government was substantial. The *Ley Topo* was considered at a moment of undiluted hostility, and became a proxy for a vote on the government itself.

The *Ley Topo* case is perhaps as close as one can get to a controlled test of Yépez' philosophy. Virtually the same reforms were attempted just over a year apart in the same legislature under the same president, once as part of an IMF programme and once not. But the political context changed. Over his term, congressional support for Gutiérrez gradually eroded, beginning with the break with Pachakutik discussed earlier in this chapter. Having lost the support of the left, Gutiérrez then exhausted the support of the right as his presidency continued, and was left with almost no support at all. Thus, since reforms failed both inside and outside IMF programmes, the case is evidence only that separating them from an IMF programme is no guarantee that they

will pass. 'Ownership' is not sufficient for successful implementation. Any benefit it brought was overshadowed by domestic political instability.

Conclusion

This chapter has examined the hypothesis that crisis might catalyse agreement to an IMF reform agenda, but not reform itself. I first considered whether, and how, crisis catalysed agreement, and found that the idea of 'weak Ecuador' signing anything for money fit only some stages. As Ecuador emerged from the crisis of 1999-2000 and its fiscal situation improved, the IMF's leverage as a gatekeeper of international finance decreased. Over the period 2000-2005, oil prices doubled from approximately $25 per barrel to $50 per barrel. By the end of the period, the IMF's leverage was so low that Ecuador sought to implement an IMF-style agenda without IMF financing, preferring to pay a small margin to avoid conditionality. However, although the start and end of this five-year period conform to a 'bargaining' explanation (weak Ecuador accepts any terms; strong Ecuador walks away from the table), within this period 'crisis'/'weakness' is an insufficient explanation of agenda-setting. Away from the extremes of crisis (2000) and unprecedented high oil prices (2005), the relationship responded as much to individual, institutional and political constraints and incentives as macroeconomic factors.

Having rejected an explanation in terms of 'weakness' as overly reductionist, this chapter constructed an alternative explanation incorporating a wider range of reasons for agreement or non-agreement. As the crisis receded, negotiator autonomy increased and personal ideology became more significant. I focussed on variance in autonomy and, when negotiators were relatively autonomous, ideology and preference formation. In stages two, three and four, although the options available to negotiators were constrained by domestic political and economic considerations, they were able to exercise agency in (not) entering IMF agreements. For this reason, it became necessary to focus on some key individuals in explaining the development of the reform agenda. In particular, the MEF leadership assumed paramount importance. Jorge Guzman's inexperience heavily impacted the agenda; Emanuel's problems of 'style' produced problems of 'substance' and no agreement at all; Pozo consciously constructed an ideologically-pure MEF team which would follow him; and Yépez, reading past reform failure and the present economic situation differently, took

Ecuador away from the table altogether. Often, a key interaction was the concordance of views between the presidents and their respective ministers of economy—the clearest examples being the Noboa/Emanuel era of spending and the Gutiérrez/Pozo era of austerity.

To investigate variation in these actors' autonomy, I considered the constraints they faced. In stage one, crisis was the dominant constraint. In stage two, the main drivers were the desire to attract new constituencies and serve existing ones, and to survive in the face of congressional and popular opposition. Additionally, Noboa's term was at the end of the political cycle, a typically expansionary 'lame duck' period. In stages three and four, Gutiérrez was surrounded by neoliberal 'true believers' who reinforced each others' commitment. Unlike Noboa, Gutiérrez and his team were facing four years of governance; there was less option of postponing austerity.

As crisis receded, ideology and personal talents became important even given these constraints. In stage two, leaders chose to prioritise running for office and serving their existing constituency, decisions which necessitated populist policies, over promoting neoliberal reforms. Pozo faced militant opposition in stage three, but his faith in neoliberal remedies influenced his shaping of the negotiation team and buttressed his commitment to the reform agenda and his belief that its benefits would become apparent to all. Neither Pozo nor Yépez aspired to political office; this is as much due to their personal qualities and preferences as to their institutional context. Unlike Emanuel, a brilliant and flamboyant figure, Pozo and (especially) Yépez shied away from the media and lacked the necessary presence to turn their tenure as Minister of Economy into an electoral bid as others have. No matter what Pozo did in office, he probably could not have been an effective candidate. Throughout his tenure and afterwards, he demonstrated a corresponding lack of interest in politics.

Within the same ideological camp, leaders pursued different strategies as they learned throughout the period. Although economic performance varied, there was no simple determinism of leaders' reaction; it depended on their perception and interpretation of the situation and the options available to them, the merits of each, and their personal and political goals. The clearest illustration of this comes in the difference between Pozo's desperate attempts to sign an IMF agreement in June 2004 and Yépez' rejection of the project less than a month later. Both Pozo and Yépez shared the same neoliberal orientation and aimed at implementing the same structural reforms, but as individuals, they interpreted their structural and economic constraints

differently and therefore had a different interaction with the IMF. A similar discrepancy occurs between the end of Arosemena's time in office and the beginning of Pozo's. Given similar macroeconomic and fiscal contexts, various Ministers of Economy followed different strategies.

The strategies of the IMF also changed over the period 2000-2005. After granting so many waivers in stage one, by stage two the IMF was placing more emphasis on prior actions. In 2002, the Ecuadorians had no opportunity to sign an empty agreement as they had in 2000. Had they had the chance, they may have done so, having 'learned' that it was possible to ignore conditionality with impunity. Then, in 2003, the MEF context changed. Considerations of waivers and the consequences of not implementing conditions became largely irrelevant since both sides agreed on the reforms to be undertaken, and thought it would be possible to complete them. This rendered irrelevant any lessons learned by Ecuadorian officials over the years of negotiating with the IMF (such as, the utility or otherwise of going direct to Washington, of obfuscating numbers, and of hiring PR firms to lobby Congress). Together, the stages indicate that an administration in which the IMF had confidence could be trusted with a degree of interpretation; one that the IMF had less confidence in had to sign a detailed agreement; and there was one administration (Emanuel's) in which there was so little confidence that no conceivable agreement would remedy the situation.

The second part of the hypothesis was that aspects of the negotiation process might set the reforms up for failure. The evidence presented in this chapter seems consistent with this. In 2000, a detailed, comprehensive agreement was signed quickly during crisis by a minister who, it is said, neither understood nor questioned the terms. Just as Haggard predicted, crisis increased technocratic autonomy and produced more radical reforms—but the ambitious agreement proved ill-suited to Ecuador as it emerged from crisis. As a result, during implementation, a record number of waivers were issued as institutional and personal incentives at the IMF combined with a domestic disinclination to undertake difficult reforms. The agreement was essentially abandoned (though, for reasons laid out above, officially 'complete'). In 2003, the IMF did not need crisis to increase the technocratic autonomy of the Ecuadorian side; Pozo, a true believer, increased his own autonomy by eliminating internal opposition, and a streamlined, orthodox IMF-MEF-Central Bank team developed an ambitious reform agenda quickly and harmoniously. Stage three shows that even without crisis,

technocrats can insulate themselves, purge their team of outside influences, and conduct negotiations so rapidly that constituencies (even other members of the executive) do not have time to react. Chapter One introduced the concept of 'bounded rationality', by which technocrats make decisions on the basis of limited knowledge. Pozo 'bounded' his own 'rationality', consciously constructing a universe of negotiation in which only pre-approved views were aired. In doing so, however, Pozo undermined implementation by helping to turn a potential key ally into an entrenched opponent.

Clearly, some of the seeds of reform failure were sown during the negotiation period. We now need to examine whether these grew and halted reform. The next chapter will therefore consider reform implementation. As well as taking up the issues raised in this chapter, the next chapter will delve into the domestic political economy of vested interests and veto players, examining the constituencies opposed to each reform, and how they were able to defeat the reformers. In 2003, during implementation, while wages were more successfully kept low, and a variant of civil service reform passed, attempted reforms in social security, customs, oil, electricity, and telecommunications all failed. In 2000, the agreement was 'complete' only because of waivers.

As this chapter has shown, the concept of 'completion' is not as cut-and-dried as the literature might suggest.[153] The designation of programmes as officially 'complete' or 'incomplete' can be highly political, the decision whether to grant or withhold waivers dependent on a range of factors. Then, 'completion' without waivers can reflect more good luck than good management, as in 2000 when it appears that the fiscal targets, initially considered ambitious, were surprisingly easy to meet due to exogenous factors. Compliance with the 2000 agreement is not evidence of IMF influence over domestic management but rather the unexpected side benefits of dollarisation. For these reasons, the next chapter will examine the 'failure' of structural reforms in both agreements, not just the cancelled 2003 agreement.

[153] For example, the large-N studies cited in Chapter One which attempt to correlate completed/uncompleted reforms with a wide range of political and economic factors.

Chapter Three: The Reform Agenda Fails to be Implemented

The previous chapter showed the emergence of the reform agenda. We saw that in 2000, due to crisis and urgency, the IMF dominated the agenda-setting process and that in 2003, the agenda was generated by a group which had been purged of its heterogeneity. In both cases, the agenda which emerged was ambitious. The task of this chapter is to investigate what happened after the negotiators left and implementation began—or did not begin. Why was the executive unable to implement the reform agenda it had committed to? How did the optimism of the IMF negotiations twice end in failure?

To answer this question, I develop a 'veto player' analysis drawing on the concepts introduced in Chapter One, especially the approach to identifying 'veto players'. This chapter and the next will investigate who these veto players are, how many there are, where they are located in political space, what their preferences are ('derived' and 'discovered') and how they exercise their preferences by using their veto. I aim to show not just that a veto player analysis can be developed, but that the correct one is being developed.

This chapter thus has four tasks. The first task is to establish whether and which veto players blocked the major reforms. In particular, I shall need to consider who among the actors opposed to a given reform possessed a *veto*. This will tell us how many veto players there are (the number of veto players being the major explanatory variable of policy stasis in Tsebelis' original work). The size, shape and relative position of winsets is also important in explaining stasis. Are veto players' preferences very different or even incompatible? In such a case there would be no feasible winset, and therefore no possible reform. The second task is to consider change over time. Did veto players always have a veto, and if not, on what was this contingent? As well as contributing to our understanding in its own right, this second task serves as a check on the accuracy of the first. The third task is to consider the limits of a simple and promising 'veto player' explanation: executive-legislative deadlock. The executive negotiates with the IMF, but must make commitments which depend on the legislature, and Ecuador's IMF agreements have contained several legislative schedules which the legislature refused to pass.[1] But other important

[1] For example, the 7th April 2003 Public Information Notice underscored that "timely congressional approval of the reform was crucial" (IMF 2003a). In 2003 Congress failed to approve the budget

reforms in the 2000 and 2003 agreements were not dependent on the legislature, including administrative customs reform, electricity and telecommunications privatisation (the enabling legislation having passed in 1996), and contracting private administration for state utilities. Curiously, these reforms also failed. The third task will therefore be explaining why reforms which did not need to pass through the legislature were no more successful than those that did. The fourth task is to consider the implications of this analysis for agenda setters.

To complete these tasks, we need to examine implementation in detail, focussing on a manageable number of cases. This chapter therefore traces seven of the most significant reforms from the executive to Congress and then to the institutions charged with implementation. In this chapter, we shall see that veto players proliferate and their winsets often do not overlap; that veto power can be created (and lost) and that executive-legislative deadlock accounts for much of the failure of the reform agenda, but cannot fully explain it. The cases reveal that a full explanation of stasis lies in three areas: *executive incapacity*, arising from the lack of input into the reform agenda from institutions charged with implementation, and also the decline of those institutions; *legislative opposition* to executive proposals, only rarely overcome; and a proliferation of *societal veto players*, working not only through the legislature but also directly on the executive.

These three factors capture three aspects of a veto player analysis. In any struggle, the ability of X to beat Y and the inability of Y to beat X are two sides of the same coin. It is therefore useful to consider state weakness as well as veto player strength. 'Executive capacity' reflects the (in)ability of the executive to either remove a group's veto or to persuade a group not to use its veto. For example, a capable executive could remove a group's veto by being internally cohesive and retaining popular support, making it hard to credibly threaten. Or, a capable executive could persuade a group not to use its veto by changing the group's preferences or by offering some other good. The second two factors consider veto players directly, splitting the analysis along legislative and societal lines. This split is because interest groups and legislatures interact in four different ways which should be kept distinct to illuminate their ability to veto: some groups are tightly tied to their legislative representation; some groups' legislative representation is autonomous and power-

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included in the IMF Letter of Intent and, largely because of this, a supplementary Letter of Intent had to be negotiated.

seeking; some groups' primary locus of activity is outside the legislature; and some groups support parties *ad hoc*. By separating society and legislature, we can better study their interactions.

I argue that each reform's failure can be traced to one, two, or all three of these factors; that is, based on these case studies, any one is a sufficient cause of reform failure. I further argue that these issues are important because all reform proposals involve an implicit cost-benefit analysis, and the more complex the political terrain, the harder it is to make tradeoffs. Examining the political economy of the seven reforms will reveal the complexities of veto players and their interactions. I conclude that insisting on reforms without understanding the Ecuadorian political context may bring more costs than benefits.

The chapter is structured as follows. First, I outline the institutions charged with implementation. The bulk of the chapter then discusses the seven reforms, in three sections: the first section introduces institutional veto players, the second adds partisan players, and the third examines three more complex reforms with multiple and intersecting veto players. The conclusion revisits the chapter's four 'tasks' in light of the cases.

The decline of Conam

As we saw in Chapter Two, the Ministry of Economy and Finance (MEF) dominated agenda-setting. But implementation was the job of a raft of institutions, including the MEF, Central Bank, Conam, Ministry of Energy, and Solidarity Fund. In some cases, as we will see, those leading these institutions did not agree with the reforms and blocked their implementation. The one institution which supported the IMF agenda lacked capacity. This was Conam (*Consejo Nacional de Modernización*, 'National Modernisation Council'), established to lead neoliberal reform. Under Noboa, Conam was prestigious but ineffective; under Gutiérrez it was neither prestigious nor effective. In general, everything Conam led from 2000-2005 failed. Conam was launched enthusiastically in 1993 to administer privatisations and concessions and improve state efficiency, but has been in slow decline since its inception. It is seen—in hindsight—as initially strong and capable, dedicated to research and policy recommendations and achieving some early successes in privatising highways, maritime ports, and the airport of Quito. However, when Bucaram attained power in 1996, he gave the Conam leadership to Omar Quintana, a

man not highly reputed for his intellectual capacity.[2] The position of head of Conam is seen as pleasant, prestigious and relatively lucrative, and thus is a prime candidate for use as a political favour. Alarcón's appointment of Patricio Pena, who had private sector experience but lacked political power, was followed by Mahuad's appointment of Alvaro Guerrero, who reorganised Conam and reduced internal costs but achieved no external goals, resigning shortly before the crisis.[3] After 2000, Conam initially appeared to be regaining importance, as President Gustavo Noboa named his brother Ricardo to head the agency. But even then, although Conam produced studies and draft legislation, there were few concrete outcomes. According to those who worked there at the time, Conam's top priority under Ricardo Noboa was the electricity sector, followed by the telecommunications sector.[4] Neither reform actually came to fruition.

Under Gutiérrez, Conam declined swiftly. Gutiérrez appointed as head of Conam his friend Carlos Vega, who had been treasurer of Gutiérrez' presidential campaign.[5] Conam's decline is attributed by several insiders to Vega's lack of relevant experience, exacerbated by Vega's expansion of his own role. Conam had always been governed by a politically-appointed director and an executive director who specialised in administration; Vega assumed both functions. Moreover, when Vega began virtually the entire staff of Conam was dismissed—even the drivers and receptionists. By January 2005, Conam's staff had decreased from 400 to 30—none with over two years' experience—and the budget from several million dollars to under $700,000.[6] Conam's public profile also dropped markedly from 2000 to 2005.[7] A further indication of the decline of Conam is its central role in developing important fiscal responsibility legislation under Ricardo Noboa, and the conviction of MEF officials that Conam would not be capable of assuming the same role today.[8] The *Ley Topo* developed in early 2005 bypassed Conam completely, even though it incorporated some of the earlier work of Conam under Noboa. Conam became an object of derision from the MEF, and major tasks that Conam saw as its own—the sale of state discount bonds, for example—were claimed by other institutions (in that

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[2] Interviews, policy-makers from various ministries and political backgrounds, Quito 2005.
[3] *Business News Americas* (1999).
[4] Interview, former Conam legal director (Quito, 7 April 2005, 4.30pm), and MEF officials, Quito 2005.
[5] *El Comercio* (2003e), *Hoy* (2003d).
[6] *El Comercio* (2005a).
[7] In a search of major newspapers, I compared the number of times Conam was mentioned in Spanish and English during Ricardo Noboa's and Carlos Vega's first two years of leadership: a drop from 167 mentions to just 40 under Vega (comparing 1 January 2000-2002 to 1 January 2003-2005).
[8] Interviews, MEF officials, Quito, 2005.

case, the Solidarity Fund). Marginalised, Conam found it increasingly difficult to justify its own existence. Its lack of leadership of the reform process left a vacuum not filled by any other state entity.

Part I: Institutional veto players

Tax reform

We move now to the cases, and examine first the simplest, tax reform. The IMF prioritised tax reform highly in both 2000 and 2003.[9] Using this case, this section outlines the impact of three important institutional players, and examines their veto attempts.

VAT increase in 2000

A Value Added Tax (VAT) increase is a common part of IMF packages in crises, when revenues need to rise urgently. The 2000 standby arrangement committed Ecuador to increasing VAT from 10% to 15% and extending it to all goods and services except basic foods, banking services and residential rents. There were other tax changes, but the VAT increase was the most important to the IMF, and the most controversial. The VAT increase was the subject of what could be seen as three attempted vetoes: by the Minister of Economy, by parties within Congress, and by the Constitutional Tribunal. Only the third was successful.

The first strong opposition came from within the MEF. Although MEF technocrats were in favour of increasing direct taxation (after all, centralisation would increase MEF control of the economy) the Minister of Economy was not. The Letter of Intent agreed to raise VAT from 12% to 15%; Minister Luis Yturralde argued for 13%.[10] Noboa sided with the IMF and the bill went to Congress at 15%. Yturralde resigned in protest. As this had no effect on the proposal, he was clearly not a veto player.

Next, Congress attempted to veto. Considerable pressure to approve the VAT increase was put on the Congress by the MEF, IMF and other multilaterals, who made repeated threats over several months. The IMF head of mission, John Thornton, warned publicly that the $304 million standby would be in jeopardy if the reform was

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[9] Interviews, IMF and MEF officials, Quito and Washington, 2005.

[10] *Latin America Weekly Report* (2000c). Yturralde's opposition to raising VAT is commonly explained as arising from his political connections to the Guayaquil business community.

rejected,[11] and a $48 million disbursement was made explicitly conditional on the VAT increase passing through Congress,[12] as well as over $100 million in World Bank and IDB disbursements. Yturralde's replacement as Minister of Economy, Jorge Gallardo, said that if the tax reform failed, he would have to reduce public spending by 10%, and Noboa urged that the reform be accepted for the sake of the multilateral relationship.[13] However, opposing the VAT increase was popular. The previous year, millions of middle-class Ecuadorians had lost their savings in bank failures, followed by dollarisation which eroded their remaining savings and real wages, as did continued high dollar inflation. The VAT was yet another increase in the middle classes' cost of living, and unlike the crisis, had a clear instigator. In the midst of the debate, Noboa's popularity rating had declined to 28%, there were strikes in opposition to the VAT increase, and the bill faced opposition from the chambers of industry in Quito and Guayaquil.[14] Opinion polls showed nine out of ten Ecuadoreans opposed the increase.[15] As it became obvious that Congress was going to refuse the bill, at the last minute the government proposed that VAT be raised to only 14%. This was not enough, and Congress voted down the bill overwhelmingly (86 to 8).[16]

Repercussions began immediately. The Paris Club suspended a meeting with Ecuadorian officials to discuss the exchange of $400 million in debt because Congress had rejected the VAT increase,[17] and warned that if Ecuador lost its IMF deal, it would have to pay $160 million in interest dating from 1995.[18] Noboa used a partial veto on the tax bill sent by Congress, reinstating 14% VAT. This would require a two-thirds majority of Congress to overturn—meaning opposition merely had to hold. The IMF reiterated that the programme would be cancelled if the VAT was not raised by Congress.[19]

As the partially-vetoed bill returned to Congress, Noboa intensified his warnings, saying not passing it would mean losing a $150 million IMF disbursement, plus a similar amount in credits from the World Bank, $120 million from the IDB,

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[11] *World Markets Analysis* (2001).
[12] Kerr (2001c).
[13] *BBC Monitoring Latin America* (2001c).
[14] Kerr (2001a).
[15] *Latin America Regional Reports* (2001).
[16] *EIU Crossborder Monitor* (2001).
[17] *BBC Monitoring Latin America* (2001a).
[18] *EIU Crossborder Monitor* (2001). The Vice-President of the Congress called this 'blackmail' (*BBC Monitoring Latin America* 2001a).
[19] *World Markets Analysis* (2001).

$300 million from the Paris Club, and $420 million from the Financial Protocol with Spain and that this would increase country risk, reduce investments, increase interest rates and deepen the recession.[20] Standard and Poors reduced its long-term sovereign currency credit rating to CCC+ from B-, and revised its outlook from 'stable' to 'negative', saying it could get worse if Congress overturned the Presidential veto on the VAT increase.[21]

Most importantly, Noboa used the time before the bill returned to Congress to make a deal with the PRE party. Rumours abounded that the PRE deal involved allowing exiled PRE leader Bucaram to return.[22] There were numerous other rewards reported: one PRE legislator gained a governorship for his son, others gained diplomatic posts and high government office, public works and government loans.[23] On re-consideration, 14 of the 22 PRE legislators abstained or did not attend the vote.[24] This made it impossible for the opposition to gain the two-thirds majority needed to overturn the presidential veto. Angry opposition legislators called it 'barefaced bribery'.[25] At this point, a clear simple majority of Congress was opposed to the VAT increase, and only PRE's abstention let it sneak into law. There remained one recourse for the opposition: the Constitutional Tribunal.

The Constitutional Tribunal is a significant veto player in the Ecuadorian system, notoriously politicised and acting somewhat like a second chamber of the legislature.[26] The Tribunal has considerable powers: it can judicially review and suspend laws, decrees, statutes, ordinances and regulations; rule on the constitutionality of legislation; and judicially review, stop and reverse administrative acts of public authorities. Its rulings cannot be appealed by any branch of government. The Tribunal's nine members are appointed or elected for four years: two representatives of the president, two of the Supreme Court, two of Congress, one of the mayors and provincial prefects, one (in total) from the official national associations of workers, indigenous and peasants, and one (in total) from the official chambers of production. The Congress confirms Constitutional Tribunal members,

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[20] *BBC Monitoring Latin America* (2001d).
[21] *EIU Business Latin America* (2001).
[22] *BBC Monitoring Latin America* (2001b), *Latin America Regional Reports* (2001).
[23] *El Comercio* (2001), Mejia-Acosta, Araujo *et al.* (2004:83).
[24] *BBC Monitoring Latin America* (2001b),
[25] *Latin America Regional Reports* (2001).
[26] Evidence presented by Mejia-Acosta, Araujo *et al.* shows that the Constitutional Tribunal was more likely to act in cases with "some partisan or ideological salience" (2004:39).

and the body constructed reflects the legislative makeup.[27] Although according to the constitution, the members of the Tribunal must meet the same educational requirements of the Supreme Court, and are subject to the same restrictions, in practice these requirements are often not followed.

At the time the VAT reform passed, the Tribunal was dominated by representatives of the opposition, an ideologically-heterogeneous alliance of convenience. These opposition parties duly appealed to the Tribunal, which duly declared the VAT increase unconstitutional on a legal pretext which was scarcely relevant. Four months after the VAT increase was announced, it was annulled. In Noboa's words, this "dynamited the government's economic programme".[28] However, during the four months before the Tribunal's announcement, Ecuador had already received its IMF disbursement.[29]

Earmarking in 2003

Ecuador's tax system is highly complex. There is extensive 'earmarking' for specified, often unrelated, projects—for example, a tax on telephone bills funds water services and sports. The IMF and MEF argue this earmarking restricts the MEF's flexibility, especially its ability to respond to shocks.[30] Under the 2003 agreement, a bill to reduce earmarking and extend VAT was to be passed by August 2003.[31] But when August came, the bill was still under 'public discussion'. The deadline was missed, and a belated attempt to pass legislation through Congress also failed.

This failure was due to veto players' 'outcome' and 'positional' preferences (see Chapter One). Regarding outcomes, the tax bill was opposed by parties across the spectrum. Each specific instance of earmarking had arisen in response to specific vested interests, who therefore opposed their removal. The rich also opposed closing tax loopholes and increasing tax on vehicles; the parties of the poor opposed extending VAT. Regarding positioning, the August 2003 deadline came at the height of the tension between Pachakutik and the PSP. The PSP had lost its main ally, had

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[27] Mejia-Acosta, Araujo *et al.* (2004:37-8).
[28] Moss (2001).
[29] Kerr (2001c).
[30] "Extensive revenue earmarking" was highlighted as a prime cause of fiscal rigidities in the central government budget, constraining its use as a tool for macro-economic adjustment (IMF 2003a, IMF 2003b). Earmarking is consistently portrayed as the most important component of the tax reform law (for example, see Government of Ecuador 2003b:B4).
[31] By 2003, the government had given up trying to raise VAT, but the bill intended to apply it to new areas.

only six seats in Congress, and had not yet made new alliances to replace Pachakutik. It was clear that a tax reform sent at that time would be doomed. No party wanted to ally themselves with the government prematurely, since the coalition was breaking down and the government's popularity had recently plummeted. In November 2003 it looked briefly as though Gutiérrez could cobble together support for a diluted tax reform bill by dropping some of the provisions that the PSC were opposed to.[32] However, just then a scandal broke out over drug money allegedly financing Gutiérrez' electoral campaign. The embryonic alliance crumbled and Gutiérrez' political advisors told him to withdraw the bill to avoid an embarrassing defeat.[33] Although again, there were threats of sanction—the third disbursement, of $42 million, was explicitly conditional on the reform being passed—the government had no choice but to postpone the reform's presentation to Congress. Then, after the IMF agreement collapsed, the MEF still wanted to enact the reform. After all, reducing earmarking would directly increase its own influence. But the bill was delayed for the remainder of Gutiérrez' term, as political emergencies continually arose.

Discussion

This case is the most straightforward example of a reform failure in the Ecuadorian case. Many of its elements are repeated in other cases. Firstly, although the executive as a whole is an agenda setter and thus a veto player by default, an individual member of the executive—even the Minister in charge of the reform in question—does not necessarily have a veto. Similarly, Congress is a veto player as a whole, but a capable executive can deal with individual parties and remove this veto. However, the two-thirds threshold for a Congressional override is higher than the Constitutional Tribunal's majority threshold, and the executive was unable or unwilling to make the deals which would have been necessary to win half the votes. The Congressional opposition thus *was* a veto player, just through a different institution. We also see the contingency of players' ability to exercise their veto. Timing is as important as content in considering the failure of the reforms. Twice, the tax reform in 2003 was unable to proceed because of politically-unrelated events which reduced the political capital of the government and made it harder for Gutiérrez to sustain a coalition. Timing influenced the positional calculations of the parties

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[32] *EIU Business Latin America* (2003b).
[33] *BBC Monitoring International Reports* (2003a).

within Congress (that is, the costs of being associated with the government rose when the government was amid drug scandal) and gave veto players an incentive to veto. Because many parties could not support the policy for political reasons (a party whose brand would suffer badly from association with drug money; or Pachakutik, who had only just exited an alliance), this effectively reduced the number of potential coalitions and meant those parties willing to negotiate were strategically stronger. Noboa dealt with a similar situation in 2000 by doling out concessions; Gutiérrez was unable or unwilling to do so.

Part II: Societal veto players

Having introduced institutional veto players, this section examines three reforms showing how societal veto players are spread throughout the system. Crucially, societal and partisan vetoes in Ecuador are not restricted to one side of the political spectrum. On each side of the major cleavages in Ecuador sits a societal group with a veto. In this section we examine three IMF reforms which were blocked by three quite different veto players: corrupt business groups via their congressional representation; public sector unions; and indigenous peoples.

Customs reform

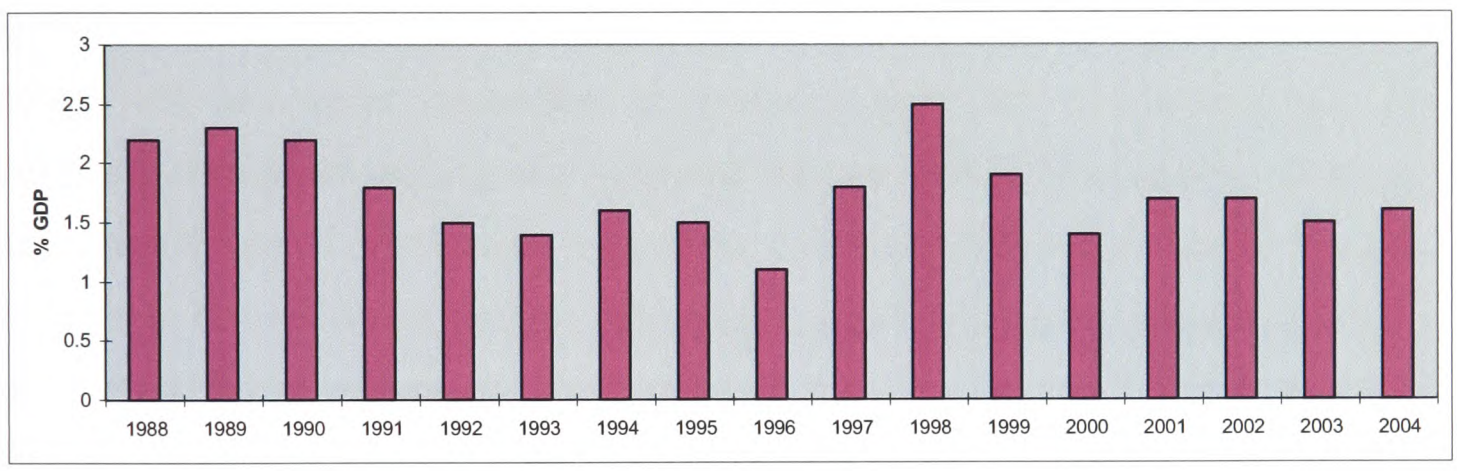
The Ecuadorian customs agency is a notoriously corrupt arena in which public and private actors cooperate to deprive the state of revenue. This section introduces a collective veto player which is difficult to investigate: powerful economic groups often linked to corrupt networks. The links between political parties and smugglers who benefit from the status quo are well known in Ecuador, though undocumented. Customs is often said to be controlled by a 'mafia', an organised crime network of officials, businesspeople and politicians.[34] There are three groups of vested interests: corrupt officials and politicians who solicit and receive bribes, importers who pay less in bribes than they would otherwise in taxes, and smugglers of contraband. A 2004 study by the Chamber of Commerce of Quito found that contraband passing through customs represented between 9% and 11% of GDP, or between $2.5 billion and $3

[34] For example, *Xinhua News Agency* (2003), Herrera (2003).

billion annually.[35] It is commonly said that for every container that goes through customs, another one goes around the back.[36] As one high-level IMF official said in an interview, "It is a snake pit… This is really where the money is."

The 2003 standby agreement committed Ecuador to bringing the customs and tax agencies under one umbrella, and specifically under one institution, the Inland Revenue Service (IRS), headed by a woman who had revolutionised tax collection (see Chapter Four) and whom the IMF and MEF teams knew and trusted.[37] The customs reform ultimately depended on the executive, *not* the legislature (unlike the tax reforms). But the executive lost conviction as its political capital fell. The reform failed and, as figure 3.1 shows, customs revenues stayed level from 2000 onwards.

Figure 3.1: Customs duties as a percentage of GDP



Source: Central Bank of Ecuador (2005) 'Operaciones del Sector Publico No Financiero', www.bce.fin.ec.

How it happened

Customs was not seriously addressed until the 2003 agreement. Although Noboa recognised the need for reform, his attempts were limited to appointing his priest, Carlos Flores, as the manager of the Customs Corporation of Quito. Noboa said he wanted honest leadership in customs and believed a priest would guarantee that. Unfortunately Flores was later found to have created a 'parallel customs' and embezzled $10 million.[38]

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[35] *El Comercio* (2005f). This falls at the high end of contraband estimates for Colombia and Bolivia (commonly 3-10% GDP).
[36] Interviews, member of Congress (2002) and political analyst, Quito 2005.
[37] Interviews, IMF and MEF officials, 2005.
[38] *El Nuevo Herald* 2003, *Agence France Presse* 2003. The former national GM of the customs agency was also implicated (*Hoy* 2003b).

In 2003, the reform coalition had several advantages. Firstly, customs reform was enthusiastically 'owned' by the Ecuadorian negotiators. IMF insiders reported that the impetus to reform customs came purely from the Ecuadorian side—although the IMF negotiators welcomed it—and that Gutiérrez wanted conditionality to strengthen domestic resolve. Moreover, unlike the VAT increase, customs reform had broad societal support. Some commentators predicted when the IMF deal was announced that this reform would be the easiest to comply with, as it was the most popular.[39] The IMF agreed to front-load the customs reform to take advantage of the executive's manifest conviction, and the World Bank contributed technical recommendations.[40]

Just a month after the 2003 agreement was signed, legislation was sent to Congress to bring the customs agency under the administrative control of the IRS.[41] Since 2001, IRS Director Elsa de Mena had been *ex officio* president of the Customs Agency, but had never controlled its administration. She had modernised the notoriously-corrupt tax agency and increased takings dramatically, and the IMF and MEF hoped she could do the same in customs. The personnel structure of the customs office was to be overhauled, and the IRS would upgrade information systems and take charge of all other aspects of administration. It was made explicit that this was intended to reduce corruption and thereby increase revenue.[42]

There were several reasons for a customs 'mafia' to oppose the proposal. Until 2003, the Board of Directors of customs was governed by unanimous vote, giving the business representative *de facto* veto power. The agency was thus highly conflicted, run by those it was meant to regulate. Not surprisingly, introducing a majority vote was opposed by political parties linked to import-export firms. This is reflected in the geography of opposition: the three parties most strongly opposed to customs reform were the three representing the coastal provinces (PRE, PRIAN, and PSC), where most goods arrive and are processed.[43] The PRE party is particularly often alleged to be associated with contraband and tax evasion in customs.[44] Additionally, an integral part of the proposal was moving customs administration from Guayaquil to Quito.

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[39] Oxford Analytica (2003).
[40] Interviews, World Bank and IMF officials, Quito and Washington 2005.
[41] In interviews, MEF and IMF technocrats agreed that the problem was one of administration.
[42] Government of Ecuador (2003a).
[43] As one IMF official said, "the costeños think they own the customs agency..." See also Oleas and Yépez (2003:18).
[44] A range of interviewees made such statements.

This intensified the resistance of coastal parties to the reform, as they and the business interests they represent would have less control over customs if it left the coastal centre. Personnel would likely be Quito residents with no party links to the coast. However, this provision also opened up an argument against the proposal as a whole: the parties called the proposal 'centralisation', contrary to the goal of 'decentralisation' enshrined in the constitution.[45]

In Congress, the legislation was subject to a long and complex process: negotiating the initial draft, floor amendments in Congress, partial vetoes by the President, and congressional overrides of some vetoes. It was submitted five times. Each stage was complicated by the many parties represented in Congress, whose positions changed often, usually for reasons which were deliberately left unclear. During the legislation's passage, parties occasionally changed their vote on major issues as a result of quiet cross-party conversations during the session. Several parties voted 'strategically' for proposals they fundamentally disagreed with, in the hope the president would more readily veto radical versions. Here I summarise only the most significant positions and outcomes.

Before the customs legislation reached the Congress, pressure on Gutiérrez from the PSC caused it to be watered down. It was known at this stage that the government did not have the numbers in Congress to pass it.[46] Just before the legislation was first introduced to Congress, Gutiérrez held a meeting with PSC leader León Febres Cordero.[47] This established a temporary alliance between the PSC and the PSP.[48] The bill finally sent provided that the IRS would absorb the functions of the Customs Corporation. This fulfilled the prior action. But in the version which passed, this provision was removed. Opponents of reform failed to preserve the *de facto* veto power of the business representative, but succeeded in the much more important task of preventing the efficient IRS taking over customs administration. Worse, the legislation was worded in such a way that Gutiérrez could not partially veto the legislation and reinstate it (as Noboa had with the VAT increase). The PSC engineered the defeat, and the PSP, Gutiérrez' party, walked out before the vote.

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[45] Oleas (2004c:67).
[46] Temple (2003).
[47] Variously reported as taking place on 19 February, 2003 and 21 February, 2003.
[48] Interview, former member of PSP alliance, Quito 2005; Oxford Analytica (2003). Party members insisted they had not made any deals (*Latin America Weekly Report* 2003).

Gutiérrez and his economic team were unwilling to veto the bill as a whole, as the IMF deadline was approaching, it could be years before another customs bill was approved, and Gutiérrez had after all promised in his campaign to fight corruption. Instead, Gutiérrez used a partial veto to propose that the customs agency's executive board overhaul it and dismiss any officials deemed unnecessary or inefficient, and added a clause facilitating military involvement in customs administration.

Just as in the case of tax reform—and also despite explicit warnings that this would endanger the IMF agreement and the upcoming disbursement[49]—parties in Congress attempted to overturn Gutiérrez' veto. In this case, however, most of the line-item vetoes were allowed to stay, with a time limit on the military's presence in customs the only point overridden. The key provision had already been excluded. The final version of the legislation allowed the tax and customs agencies to share data, and gave some extra legal powers to the IRS.[50] Although the law fell far short of the version originally agreed with the IMF, it was enough to help secure the approval of the IMF Board in March.[51] In the supplement of July 23, 2003, the Ecuadorian government requested a waiver for the structural performance criterion relating to customs reform.[52] No further customs reform was attempted under Gutiérrez.

Despite these events in Congress, lack of customs reform is best blamed on the executive, not the legislature. Although the legislation which would have *forced* the administration to put the customs agency under the IRS was blocked, in fact the executive could have achieved the same effect without any such provision. This was because the new legislation provided that the Board of Directors operate on a majority vote rather than by consensus. The head of the Congressional Economy Commission, Simon Bustamante of the PSC, claimed this meant de Mena would "no longer have her hands tied".[53] But although this helped, policy at Board level was never the real problem. De Mena had been President of the Board since 2001, but had been unable to reform because she did not control administration, only policy. The real impact of the majority vote provision was that Gutiérrez could nominate whomever he chose to

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[49] *El Comercio* (2003c).
[50] *EIU ViewsWire* (2003a).
[51] *Ibid.*
[52] Government of Ecuador (2003b).
[53] *El Comercio* (2003f).

be the GM, since the executive directly controls three of the four votes on customs' Board of Directors.[54]

The coastal business groups which would suffer a great loss turned their attention to persuading Gutiérrez to nominate someone more malleable than de Mena. At this stage tension was growing with Pachakutik, and Gutiérrez was searching for congressional support elsewhere. As Gutiérrez' PSP party had only six of 100 votes in Congress, he was heavily dependent on coalitions and vulnerable to rent-seekers. The three major coastal parties (PRE, PSC, PRIAN) together held 49 seats. Angering parties Gutierrez might soon need was out of the question.

Reforming customs would be a major job, requiring a complete retrenching of staff and an administrative overhaul. However, Gutiérrez installed a colonel from his graduating class with no experience in administration.[55] De Mena, President of the Board, disagreed with the appointment but was powerless. Though in theory de Mena had a veto, using it against Gutiérrez would have led to her instant dismissal, as she held her position at his discretion. Thus, as de Mena says, "I never had control of the administration. There was no political will to fix customs..."[56] In an nod to his campaign promises, Gutiérrez installed military officers in customs, and allowed the World Bank to improve the agency's information systems. But while electronic systems cleared goods faster, customs remained corrupt.

Discussion

The problems in customs were due to executive weakness. The majority of the Board of Directors was controlled by the President and thus the potential transformation of customs was entirely within the hands of the executive; the President merely had to name the right person to help de Mena. Instead, the reforms in customs were traded for political support from other parties. Despite public support and multilateral pressure—including the threat of missing a deadline for a disbursement from the IMF—the veto players won against a vulnerable executive.

The customs case demonstrates how powerful groups can operate through political parties, and also how they can operate outside of the legislative structure by

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[54] Namely, the President of the IRS and the Ministers of Economy and Trade. The fourth is a private sector representative.

[55] *El Universo* (2004a).

[56] Interview, 8 April 2005, 9am, Quito: "The law exists, but there has not been political will. Political will means naming a technical manager and ensuring those who come are technical people, professional, with values. And no government has wanted to do this."

influencing the executive directly. In doing so, the powerful business groups managed to exercise their veto power over the reform in two stages; firstly by watering it down in its legislative stage into something they could defeat, and then defeating it using their power over the executive. The first stage looked like compromise, but in fact merely redirected and delayed the defeat of the reform. As the customs reform was one of the few on which the MEF, the IMF and Pachakutik all agreed, its failure indicates that coastal business opposition to a reform is sufficient to override support from diverse groups. The case also shows the contingence of the veto. When Gutiérrez arrived and his alliance with Pachakutik was strong, Ecuadorian negotiators were enthusiastic about taking on these corrupt forces in customs. When Gutiérrez' support in Congress weakened, he needed the legislative representation of these same groups. For a vulnerable administration, survival outranked compliance with an IMF agreement. On the other hand, the executive's reaction also shows a lack of capacity to manage this situation or, perhaps, a lack of real commitment to the customs reform; there are always other options for negotiating with parties, as the VAT case showed.

Civil service reform

Like the customs reform, the civil service reform was included in the IMF conditionality at the request of the Ecuadorian economic team, who in 2003 were under heavy pressure from public sector wage arrears.[57] The MEF felt the public wage bill was out of control: it had grown from $900 million in 2001 to $2.3 billion in 2003,[58] and over 200 public employees earned more than the President.[59] The Ecuadorian economic team was unable to calculate the fiscal effect of changes in wage policy, as each individual's salary was set independently, with a different rate of wage growth and a different configuration of 'bonuses'.[60] Reformers intended to improve transparency and better control public wage expenditure by harmonising salaries (unifying pay scales and abolishing bonuses), and facilitating dismissals.

The civil service reform began simply but quickly became much more complex, 'a 250-article monster'.[61] The initial proposal was to increase social security contributions by including all salary components in assessments. Under the status quo,

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[57] Interviews, MEF officials, Quito 2005.
[58] Yépez called the public wage bill the economy's 'Achilles' heel' (*Hoy* 2003h).
[59] *Hoy* (2004).
[60] Interviews, MEF officials, Quito 2005.
[61] Interview, Ramiro Galarza, Vice-Minister of Finance, 7 April 2005, 12pm, Quito.

private sector employees had to pay social security contributions on 100% of their salary but public servants only on 15-20%, although all received the same benefits. However, in talks between the MEF, Central Bank and Gutiérrez the project quickly expanded to wage homogenisation and workers' rights. One MEF official said, "It got complex. We lost control of it. The IMF had no experts on it. They read it and didn't know the impact. They kept asking us for the fiscal scenario. But no one knew how to put it into numbers. Nobody knew what was going on. I mean *nobody*."[62]

Then, several sectors asked to be excluded: the foreign service because they work abroad, the judiciary because they wanted to be separate from the rest of the public service, and the armed forces and teachers who argued their promotional ladders were incompatible. Each of these sectors is large and powerful and has a manifest ability to threaten a vulnerable administration. Teachers are a highly organised and militant group tied to a political party, the MPD, whose support of the executive is often conditional on policy towards teachers' unions. As well as ideological hegemony over education, teachers have recourse to strikes which affect millions of children and their families. After schools closed on 19 April 2005, schoolchildren were a major presence in the protests in Quito which brought down the President. Then, the support of the judiciary is crucial in legitimising quasi-constitutional leadership changes, and also used as a weapon against political enemies (see Chapter Four). Military support is another necessity. Noboa was installed after a *coup d'état* when the military withdrew in his favour; Gutiérrez was particularly beholden to the military and fell when they withdrew support in April 2005.[63] After helping lead the 2000 *coup d'état* as a colonel, Gutiérrez promoted many contemporaries and dismissed many superiors, creating resentment among those not promoted. Throughout his administration he had to pacify certain factions and certainly could not deny the military the same treatment he conceded to teachers and the judiciary.

In the end, the civil service legislation covered only 43,000 of the 300,000 public employees. It also potentially introduced net costs rather than savings—although nobody knew for sure.[64] As the MEF official continued, "So you ended up having a 250-article law, which nobody understands, that only applies to 40,000

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[62] *Ibid.*
[63] The military also gains power from its key positions in state institutions like Petroecuador and state airline TAME, which it occupies as a legacy of the military dictatorship.
[64] Interview, Ramiro Galarza, Vice-Minister of Finance, 7 April 2005, 12pm, Quito.

people! At one point we wanted to just abolish it and go back to the old one. It was a mess, no-one understood how it worked."

What happened in Congress

The civil service legislation was introduced in early July 2003. The first version, with a large section on wage unification, was voted down. Gutiérrez vetoed the wage unification section and sent it back. This was the MEF's plan; the wage unification had got out of hand and MEF officials were happy to have this part deleted.[65] However, Gutiérrez' veto was overridden on 6 August, when all parties voted against the legislation except the independents and PSC (who walked out). Pachakutik's opposition to the legislation effectively ended the alliance between Gutiérrez' PSP and Pachakutik, and the three Pachakutik cabinet ministers were asked to step down. As the other former coalition member, the MPD, had left in July, Gutiérrez was left controlling only six of 100 seats in Congress. Deals with independents could increase this, but only to about ten.

However, the opposition was also fragmented. Before Gutiérrez took office, the opposition had formed a cross-party alliance of over 60 seats, held by three major parties—the PSC, PRE and PRIAN, along with other smaller parties and independents. By August this had broken up, so neither the government nor the opposition controlled Congress. The time was ripe for building new coalitions. Again, there was pressure of IMF deadlines.[66] Gutiérrez reached out to the PSC, a party of business naturally opposed to the public sector unions' demands. The ground for an alliance had been laid by the PSP's concession on customs following the Gutiérrez-Febres Cordero meeting in February. This agreement was formalised after a series of extra concessions once Pachakutik left the governing alliance at the time of the first vote on the civil service bill. A revised version of the legislation was eventually approved in late September by the 'new majority': the PSP, PSC, Prian, DP, some independents and one Pachakutik member.

The PSC aimed to extract maximum concessions. According to one well-informed source, Minister of Economy Pozo agreed to give the PSC mayors many millions of dollars, mostly destined for public works on the coast.[67] This allowed the

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[65] It was 'postponed', but never re-emerged (*Hoy* 2003c).
[66] *EIU ViewsWire* (2003b).
[67] Interview, member of Congress, Quito 2005.

mayors to shore up popular support by claiming credit for developing local infrastructure, while simultaneously using lucrative contracts to reinforce their personal patronage networks. Gutiérrez also appointed Carlos Polit, who was close to PSC leader Febres Cordero, as Minister of Human Development, supported the proposal of PSC Mayor Jaime Nebot to refund the pension and health funds paid by Guayaquil residents, approved an unbudgeted transfer of $50 million to Guayaquil (a PSC stronghold), vetoed a proposal to transfer the headquarters of the Fisheries Chamber from Guayaquil to Manta, and held frequent policy meetings with PSC leaders. [68]

The final session in Congress was aggressive, with legislators having to be physically separated several times. In one incident a Pachakutik member raised his hand to vote in favour of a clause and was attacked by the head of the Pachakutik bloc, who forced his hand down. The President's brother, a PSP member, joined the fray and other legislators shouted insults. It later emerged that the Pachakutik member who had voted with the government had a son who was made head of Petroecuador's Internal Relations Unit two days previously.[69] The legislation passed was watered-down. The coastal parties insisted customs workers should be able to be reinstated after dismissal, unlike all other public sector workers covered by the legislation. Congress also prevented the MEF from reducing the number of employees as aggressively as the MEF wished (the workforce may not be reduced more than one percent annually). Civil service unions protested lost union rights, but this had little effect on the legislated outcome; these workers had no ability to credibly threaten.

Discussion

The two stages of the civil service reform, before and after reaching Congress, are each revealing. Before reaching Congress, groups with the ability to credibly threaten undermined the legislation without actually vetoing it outright. Instead, its coherence and the breadth of its application were undermined. The military and teachers were particularly powerful groups at this point in the Gutiérrez administration. Gutiérrez was vulnerable and depended on the support of the armed forces, and his congressional alliance included the MPD, the party of the teachers' unions.

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[68] *EIU RiskWire* (2003a).
[69] *Hoy* (2003f).

The passage of the watered-down legislation shows the role of 'positional' preferences and unrelated concessions. In August 2003, Congress appeared unconcerned that the IMF programme would fail, even though failure was repeatedly equated to foregone income and therefore austerity. There is nothing to indicate that parties did not believe the IMF would make good its threat to withhold the third disbursement (as it did). Instead, the veto players were primarily concerned with their position within the system, and only secondarily with the content of the reforms. While the business parties' opposition to the customs and tax reforms considered earlier is explicable with reference to rational outcome preferences, only *positioning* explains their opposition to the civil service reform, which was designed to 'free up' the public sector labour market. The business parties vetoed the first (watered-down) civil service reform because doing so brought the government into disrepute—but later approved a very similar version when it allowed them to win unrelated concessions. The majority of these concessions were themselves positioning gains, strengthening the PSC's control over certain institutions and its ability to deliver rewards through its patronage network. Chapter Five will investigate this patronage network further.

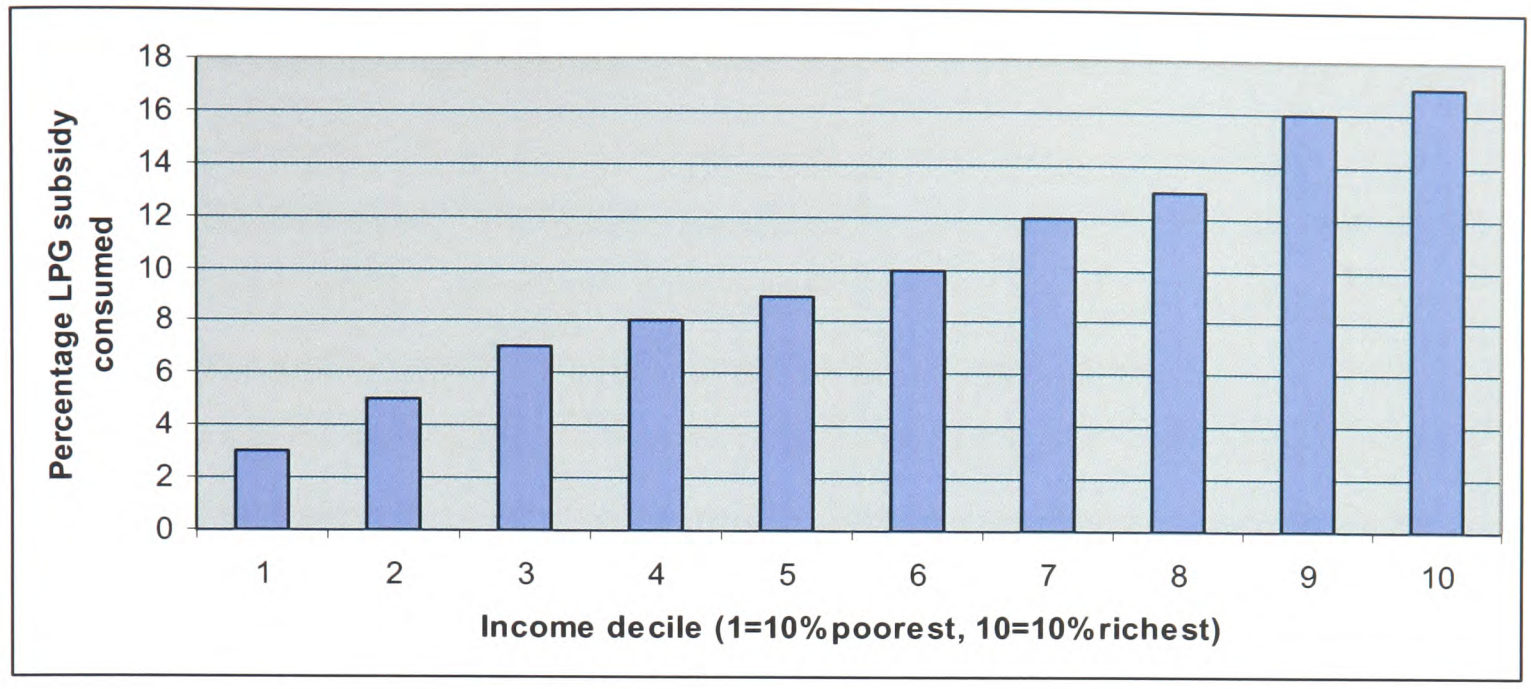
The LPG subsidy

Ecuador is one of South America's largest markets for liquefied petroleum gas (LPG), which is widely used for residential heating and cooking. LPG in Ecuador is heavily subsidised—in 2003, about 60%. From the mid-1990s, a consensus emerged among MEF, Social Welfare and multilateral lending agency technocrats that the LPG subsidy was harmful. Early research emphasised removing subsidies to enhance competitiveness, while later studies showed Ecuador's fuel subsidies were highly regressive and mostly benefited the rich and industry.[70] The World Bank/IDB Public Expenditure Review found that "the subsidy to the cooking gas is definitely not pro-poor" and furthermore, that it represented "a meaningful 10 percent of all social expenditure", the equivalent of all resources allocated to social protection programmes.[71] Figure 3.2 shows that the LPG subsidy is highly regressive and figure 3.3 shows that LPG ('cooking gas') was one of the most regressive items of social expenditure in 1999.

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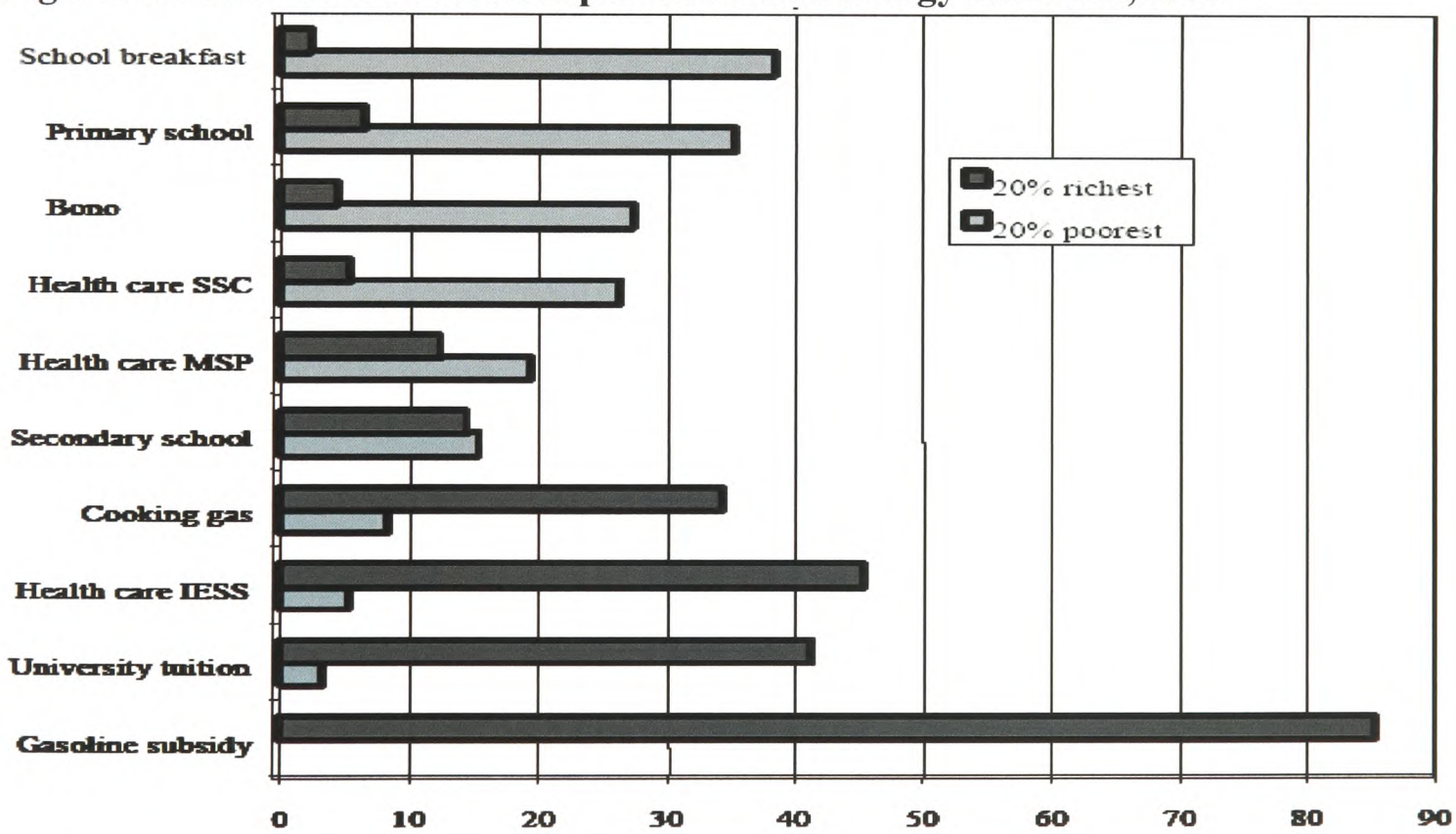
[70] See ESMAP (1991), ESMAP (1994a), ESMAP (1994b).
[71] Izquierdo, Melo *et al.* (2004:40).

Figure 3.2: Consumption of LPG subsidy by income decile, 1999-2002



Source: Cuesta, Ponce et al. (2003: 15).

Figure 3.3: Incidence of social expenditure and energy subsidies, 1999



Source: Izquierdo, Melo et al. 2004 (Figure III.I).

Subsidies on refined oil products have been a major drain on government finances since the ISI policies of the 1970s. With fixed nominal prices and regular sucre devaluation, subsidies grew until by 1991 they were an estimated 4% of GDP, accounting for a major part of the fiscal deficit.[72] Most subsidies have now gone but

[72] Babelon and Dahan (2003), Terneus (2000).

successive governments have found it impossible to remove the subsidy on LPG. The IMF, World Bank and other multilaterals have consistently pressured Ecuador to remove the LPG subsidy and this was an IMF condition in both the 2000 and 2003 agreements.[73] However, the LPG subsidy persists: in 2005 it was $281 million, over 3% of the national budget.[74] Surcharges had to be levied on other fuels to partially fund the subsidy. Much subsidised LPG (over half of which is imported)[75] is smuggled to Peru and Colombia, where it costs about four times more.[76]

From time to time during the mid 1990s eliminating the LPG subsidy was proposed, but each time there was uproar and the matter was dropped. Gradually the matter became more urgent as inflation increased the subsidy from $46 million in 1991 to $150 million in 2003.[77] In 1997, President Fabian Alarcón increased other fuel prices by 6-10% but was forced to reintroduce the LPG subsidy two days after he cancelled it.[78] In the 1998 elections, presidential candidate Alvaro Noboa made much of Jamil Mahuad's opposition to LPG subsidies, widely seen as a major reason why Mahuad lost his early strong lead and only just beat him.[79] In September 1998 Mahuad actually eliminated the LPG subsidy, increasing the price by 410%, and a 'Solidarity Bond' was established to compensate the very poorest households for their loss.[80] However, the subsidy reappeared when international fuel prices rose while domestic prices were fixed. In 1999 Mahuad backtracked, pledging to indigenous groups that LPG prices would be frozen until June 2000. The crisis then brought extremely high sucre inflation and further increased the subsidy.

In 2000, because of Ecuador's desperate financial position, and despite internal objections—including the pact with indigenous groups, which Noboa had inherited—eliminating fuel subsidies was top of the IMF's agenda.[81] The first price increase was scheduled for the end of June 2000: 60% for domestic fuels, 40% for

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[73] The 2003 Letter of Intent committed Ecuador to eliminating the subsidy by increasing the price of a 15kg tank from $1.60 to $6. The 2000 Letter of Intent specified price increases as structural benchmarks for the second and third reviews.
[74] MEF (2005), CIA (2005).
[75] SAPRI (2001). Another source has it as 75% (EIA 2005).
[76] Terneus (2000).
[77] *Platt's Oilgram News* (2001).
[78] Maldonado (1998).
[79] *Latin America Regional Reports* (1998).
[80] SAPRI (2001).
[81] As Minister of Energy Pablo Terán said, "President Noboa was calling me and the President of Petroecuador saying, 'Guys, I need money or this thing is going to blow up in pieces' They didn't have money to pay the armed forces, three months' salaries already late, people were starving. The country was a disaster. So we signed this Letter of Intent and we had to increase fuel prices." (Interview, 22 March 2005, 11am, Quito).

LPG. However, plans changed repeatedly. In April 2000, just after signing the agreement, Noboa announced the LPG price would double,[82] a month later that it would not change,[83] then that it would increase over two years to international levels.[84] This reflected an internal rift between two cabinet ministers, Pablo Terán and Jorge Guzmán. Terán and Guzmán disagreed on the feasibility of the increases, which were announced by Noboa in a cabinet session: Economy Minister Guzmán was optimistic there would be "strikes for two weeks, and then nothing",[85] while Energy Minister Terán, who was not consulted during the agenda-setting phase and dealt with the IMF only through Guzmán, knew he would suffer the personal and political consequences of announcing the policy. Together with the President of Petroecuador, Terán designed a revenue-neutral alternative with a lower LPG price, but higher industrial fuel prices.[86] At Terán's request, a meeting was held with representatives of the Ministries of Economy, Energy and Conam. Noboa appeared reluctant to break the IMF deal but was eventually convinced by Terán that the IMF proposal could be renegotiated. At that point Guzmán resigned (says Terán, "He ripped up my proposal, stood up and left"[87]).

Even this much lower price increase was highly controversial. In December 2000, the price of LPG doubled (to $2, still well below the $4-5 international price) in a package also including transport and gasoline increases. The ensuing protests involved thousands of students, indigenous people, teachers and workers and lasted several weeks. 1500 indigenous people blocked the Pan-American highway, preventing food from reaching Quito. Military action injured ten indigenous people and one soldier. Over 5000 indigenous people marched to Quito, where 4000 occupied Salesiana Polytechnic University. Fifty went on hunger strike. A state of emergency was declared, and police arrested indigenous umbrella group Conaie's president Antonio Vargas and the Popular Front's leader Luis Villacis, on charges of attempting to overthrow the government. Finally, in early February 2001, the government reversed the reforms. LPG was reduced from $2 to $1.60 per 15kg tank,

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[82] *Business News Americas* (2000b).
[83] *The Oil Daily* (2000).
[84] Eisen (2000).
[85] Interview, Pablo Terán, Minister of Energy, 22 March 2005, 11am, Quito.
[86] *Latin America Weekly Report* (2000b), Interview, Pablo Terán, Minister of Energy, 22 March 2005, 11am, Quito.
[87] Interview, Pablo Terán, Minister of Energy, 22 March 2005, 11am, Quito: "So the President just looked at me and said, 'Pablo, if you are wrong, I'll cut your head!' I said, 'President, I'll cut it myself.' " See also *Business News Americas* (2000c).

and an agreement was made with indigenous groups that prices would not rise to international levels until 2002. LPG cost $1.60 for the remainder of Noboa's term.[88]

In January 2003 the incoming Gutiérrez administration raised the petrol price by 35% but, in a concession to Pachakutik, the LPG price remained $1.60. In late 2003 the World Bank recommended that Ecuador raise LPG to $7.15 (far *above* the world price) and Economy Minister Pozo said the government would study the issue and announce a decision in December. There was a token attempt to set up a committee within the Ministry of Social Welfare, but no proposals emerged from the process. Although the IMF urged that members of the indigenous community be included in the committee to increase transparency and better communicate with the veto players, this never occurred.[89] In February 2004, Pozo announced that the LPG subsidy would remain indefinitely, saying good economic performance made it affordable.[90] As Terán reflected in 2005, "No-one will touch it. It's a political hot potato."[91]

Explaining the puzzle

The previous two sections have shown that the LPG subsidy is highly regressive, and also that the key veto player has consistently been Ecuador's poor. Why would the poor protest, starve and even risk dying to protect a subsidy which overwhelmingly benefited the rich? To explain this puzzle, this section moves beyond explanations of preference formation derived from our understanding of players' rational economic interest and examines preferences based on psychological, strategic and symbolic interests. At the root of each are rational considerations, but not necessarily the ones we might expect.

Throughout the 1970s, Ecuadorian society was heavily subsidised. In the 1980s many large subsidies—such as those on electricity, telecommunications, and wheat—were removed, with dramatic effect on the incomes of the poor. It became a non-negotiable goal of the leftwing and indigenous movements not to allow more subsidies to be removed. The last remaining large subsidy was on LPG. A key difference with earlier lost battles to remove subsidies was that while products like wheat are clearly imported, most Ecuadorians see Ecuador as an 'oil country' and do

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[88] Kerr (2001b). In 2002, a plan to abolish the LPG subsidy was again delayed.
[89] Interview, high-level IMF official, Washington, September 2005.
[90] *Latin American Weekly Report* (2004).
[91] Interview, Pablo Terán, Minister of Energy, 22 March 2005, 11am, Quito.

not realise most LPG is imported. Ecuadorians seem to have higher expectations of the state to regulate a commodity they see as state-produced.

In interviews, the LPG subsidy was repeatedly characterised as 'a symbol', especially for the indigenous movement. Fernando Buendía, the economist from Pachakutik who took part in the IMF negotiations, said, "The gas was more of a political, symbolic question for us. It's been a flag that the social movements have defended, and maintaining the price of the gas is like a display of the force that the social movements have." A former Minister of Energy called it "a political tool, a way for the leftist parties and the Indian groups to strike against the government." Its significance was summed up by one MEF official who said, "Ecuadorians believe they have two fundamental rights: to breathe, and to pay $1.60 for a cylinder of gas."[92] Just as policymakers saw the indigenous movement's objection as irrational, ideological, and 'merely' symbolic, for some technocrats eliminating the subsidy was also symbolic. Central Bank GM Leopoldo Baez, for example: "The subsidy on gas is not a very important issue from the economic point of view. It's only $200-300 million per year. But it's important because we should pay what really is the cost of cooking gas."[93]

This symbolic and strategic significance is important. But despite all sides—indigenous leaders, technocrats, IMF, politicians—characterising the issue as 'symbolic', there are also rational bases for opposition. A fuller explanation of the failure of the LPG reform concerns the flow-on effects of other prices and, most importantly, Ecuadorians' relationship to the state. Firstly, the poor may oppose eliminating the subsidy on a rational economic basis. Some fuel price subsidies have been able to be decreased stealthily, as with the oil price, not bought by the poor and largely unnoticed by them. Conversely, LPG is bought by most housewives. Although the rich disproportionately consume LPG, the poor feel the price. Moreover, the LPG price impacts small and medium enterprises and thus those who consume the products of street vendors, small-scale street restaurants, and so on.[94] The extent of these flow-on effects is unclear, but they certainly exist and exacerbate the economic loss to the poor of eliminating the LPG subsidy.

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[92] And continued, "It's passionate, emotional, sentimental, but it's untouchable. Two presidents fell for it. It's too big." (Interview, MEF official, Quito 2005)
[93] Interview, 21 March 2005, 11am, Quito.
[94] As one interviewee said, "People know if the cost of the cooking gas goes up they have to increase the price of hotdogs."

The key rational reason, however, concerns the relationship of poor Ecuadorians to the state. As Chapter Five will show, the Ecuadorian state suffers a deep credibility deficit. The coalition for LPG reform was composed entirely of agents representing or working through the state: IMF, World Bank, MEF, Social Welfare. Eliminating the LPG subsidy required the poor to trust that the money saved would be redirected to pro-poor expenditure. The technocrats felt sure the social sectors would support the removal and redistribution of the LPG subsidy if they understood it. However, officials at both the MEF and the Ministry of Social Welfare also felt this was not a role that any part of the government could play. The Social Welfare technocrats felt that they would be perceived as partisan, as the benefits of removing the subsidy would flow first to them before being redistributed as targeted transfers. Worse still would have been any association with the IMF. Bob Traa, who arrived in 2002, appears to have been the first IMF representative to attempt to persuade civil society leaders in a systematic way that the LPG subsidy was regressive. But there was much scepticism of any pro-poor message emanating from the IMF. Then, when Pachakutik was marginalised in early 2003 (see Chapter Two), this only further decreased trust in the government, and the social sectors clung to the LPG subsidy as one of their last remaining powers.[95]

Distrust of the state also explains the rejection of a proposed technocratic 'voucher' solution. LPG vouchers for the poor, equal to the difference between the subsidised and market LPG price, had been suggested as early as 1994 in a World Bank/UNDP study.[96] Energy Minister Pablo Terán revived the idea. But there was always deep scepticism among Ecuadorians that such vouchers would persist; a voucher system was seen as a temporary transition instrument and likely to be distributed as political and personal favours rather than to the very poorest. Furthermore, Terán's scheme was to piggyback on the Solidarity Bond model, known to be poorly designed (its coverage, according to a World Bank study, "deficient"[97]). Faced with the need to focus political capital to achieve any reforms, the Noboa administration abandoned the scheme.[98]

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[95] Interviews with officials in social ministries, indigenous movements, and economic think tanks, Quito and Guayaquil, 2003 and 2005.
[96] ESMAP (1994b).
[97] SAPRI (2001).
[98] Interview, Pablo Terán, Minister of Energy, 22 March 2005, 11am, Quito: "We had the vouchers printed. And I talked to the President about it, and he said, 'Pablo, if you had to pick between privatising the distribution companies or increasing the gas price, which would you do?' I said, 'Both!

Those supporting the veto players

Although the poor, especially the indigenous, have been the key veto player, three groups may have supported their protests behind the scenes. Firstly, almost all LPG (94% in 1999) is sold by four private commercialisation companies paid by the state to bottle and transport it.[99] In particular, the business of transporting LPG from large vessels to land is said to be connected to PSC politicians. It is difficult to isolate a PSC position on the LPG subsidy, as the issue was contained within the executive and did not require legislative approval. Nevertheless, for these businesses, profits relate directly to domestic LPG consumption and thus to a low (subsidised) consumer price. Inefficiencies, such as in the bottling process, would also be more evident without a state subsidy.[100] Secondly, LPG smuggling is well-known and constitutes another private vested interest. The political connections and influence of this group are unclear. Some interviewees alleged an alliance between indigenous people who know the remote terrain, the indigenous leadership who support the subsidy, and the military who turn a blind eye at checkpoints to trucks loaded with canisters. But even if some military were interested in LPG reform failing, it seems unlikely this faction was powerful enough within the military to persuade it to exercise, or threatened to exercise, a veto. Finally, the Ecuadorian middle classes were represented among the protestors and, as we have seen, disproportionately benefit from the subsidy.

The impact of these other vested interests is unclear. One high official alleged that beneficiaries of the LPG subsidy systematically used the media, government agents and societal spokespeople to convince the indigenous community that the IMF was attempting to promote an anti-poor policy. Despite this, indigenous protestors were ultimately the key veto player, whether for symbolism, economic reasons, distrust of the state, or because they are duped by the real beneficiaries. All multilateral and technocratic effort has been directed at persuading them to accept a price increase.

But, if I had to do one… the electricity. It has a bigger impact.' He said, 'Sorry, that's the one we are doing. We are not doing the gas.' …. The coupons cost $800,000 to print. They were printed in Canada, because they needed to be secure, it's like money. And they were ready to go out, but Noboa said no. They're still there. They're stuck in a room."

[99] Four state commercialisation companies account for the remaining six percent (SAPRI 2001).

[100] Interviews, economic officials and think tank academics, Quito 2005.

Discussion

Chapter One outlined the distinction between 'derived' and 'discovered' preferences, noting that material interest and power are just the beginning of the story. It seems that indigenous groups perceived the LPG issue in strategic as much as material terms, seeing success as demonstrating strength and loss as admitting weakness.

Like the customs reform, LPG reform did not depend on Congress but on executive capacity and resolve. But while those opposed to customs reform vetoed it by acting covertly on the executive, indigenous groups vetoed LPG reform explicitly. When they were unable to capture the executive, they vetoed it from without. Crucially, the indigenous groups were a credible threat, unlike the protestors in the civil service reform considered earlier. Noboa had been installed after indigenous protestors overthrew Mahuad, and would have been very aware that protests following LPG price rises had hastened Bucaram's fall. These events were recent, salient and dramatic, giving the indigenous protestors a clear veto.

In 2003, Pachakutik was part of the executive and won a concession on LPG. In Chapter Two, I argued Pachakutik could have helped implementation of reforms in general and LPG reform in particular. This section has shown why. The LPG subsidy is an example where Pachakutik was the political wing of the collective veto player, indigenous groups. The key veto player feared partial reform: the MEF removing the subsidy but not redirecting the funds to pro-poor social services. Involving Pachakutik could have increased confidence in achieving full reform. The IMF representatives in Ecuador advocated indigenous oversight for precisely this reason, but because of executive incapacity—perhaps buttressed by the other interests considered above—this never occurred.

Part III: More complex interactions of reforms and veto players

Having introduced the major veto players and cleavages, we now consider three cases involving multiple veto players and complex interactions: telecommunications, electricity and oil. As the lessons of the first two reforms are similar and the reforms related, to avoid repetition they are considered together.

Telecommunications and electricity privatisations

Ecuador is unusual in having privatised neither telecommunications nor electricity.[101] From 1995 to 2005 reformers tried and failed to privatise both sectors numerous times. Despite international support and a clear technocratic consensus, Ecuador was unable to fulfil the commitments to privatise made in both the 2000 and 2003 agreements.[102] Legislation was repeatedly voted down in Congress, bids were repeatedly withdrawn, sometimes at the last minute, and there were endless unexplained 'delays'. This failure was a major contributor to the premature dissolution of the 2003 agreement.

The problem

Everyone can find something to dislike in Ecuador's electricity sector, which is unreliable, inefficient, and inequitable. Consumption is heavily subsidised—in 2000, by $300 million, 1.5% of GDP.[103] From November 1999 to May 2000, when tariffs were frozen but inflation was high, the real tariff fell to less than one-third of economic costs.[104] Despite the subsidies, Ecuador's production does not cover its needs, and demand is only met by importing from Colombia. In 2003, if it had not been for imported electricity, Ecuador would have had to ration.[105] Furthermore, coverage is limited; by 2001 over 20% of the population had no access to electricity.[106] In 1997 the generation sector alone required an estimated $3.5 billion investment to meet projected demand by 2010, over 150% of the state monopoly Inecel's *total* (generation, transmission, distribution) assets at the time.[107] The sector is also inequitable, most subsidies going to the rich.[108]

Moreover, the operational deficit in the electricity sector is worsening. A trust is meant to collect from the state distribution companies and pay all generation companies according to an agreed hierarchy: top priority is the Colombian interconnection, second the private generation companies, third the hydro plants, and

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[101] In Levi-Faur's (2002) study of 32 Latin American and European countries, only four (Costa Rica, Ecuador, Paraguay and Uruguay) had not privatised either industry.
[102] In particular, the July 2003 Supplementary Letter of Intent committed Ecuador to introducing private sector management into the electricity and telecommunications sectors by end-August 2003.
[103] Vidaeus (2001).
[104] *Ibid.*
[105] Vidaeus (2001:14), Segovia (2003).
[106] *EIU Business Latin America* (2002).
[107] American Embassy in Quito (1997). Decades of underinvestment, the result of inadequate tariffs, were catalogued in a 2001 World Bank report: Vidaeus (2001).
[108] SAPRI (2001).

so on. Sometimes the distribution companies can pay only the Colombian interconnection and the private companies, leaving the state generation companies with growing deficits. Sometimes the private companies are not paid either. In one case, a US generation company was owed $20 million and, after unsuccessfully attempting to litigate, sold the plants at a large loss.[109] For their part, generation companies only bill about 60% of the electricity they generate, and then collect only an average of 85%—some as low as 60%. As a result, the worst-run generation companies may receive well under half the income due to them. Comparing public and private generation companies clearly demonstrates the public sector inefficiencies: even according to government figures, in 2004 the Solidarity Fund's thermal power plants received payment for about 32-38% of what they generated, whereas the private companies received about 95-98%.[110] The situation of the telecommunications companies is better, but the state monopolies have been consistently loss-making. By 2002 Ecuador had one of the lowest phone penetration rates in Latin America, with only eight lines per 100 inhabitants.[111]

Repeated failure to privatise

The national electricity utility, Inecel, was set up during the military era. Inecel monopolised generation, transmission and distribution and set electricity tariffs, following the model of state electricity provision then prevalent in Latin America and much of the rest of the world and financially supported by the IDB, World Bank, and bilateral donors. In the 1980s, however, the model began to be seen as outdated. Following the United Kingdom, first Chile and later other Latin American countries adopted a new model. The old system was a vertical, linked, state monopoly; the new system was to be a horizontal, segmented, privately owned and operated by the free market, with state regulation through an independent technical organisation.[112] The tariff was still to be set centrally, with reference to a theoretical 'efficient company'.

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[109] Ten years later the case was still in international arbitration Another company also complained it had been discriminated against in payments owed by various state entities (USHR hearing 2004).
[110] Solidarity Fund data given in interview. Note that private companies may have a different customer profile (e.g. fewer rural consumers) which might naturally raise profitability; it seems unlikely this would account for the whole discrepancy.
[111] *EIU Business Latin America* (2002).
[112] Interview, Marcelo Neira, Undersecretary for Electricity 1988-92, Quito, 5 April 2005, 8am.

In Ecuador, legislation passed in 1996 broke up the national electricity monopolies (and was mirrored by similar legislation in telecommunications).[113] The Ecuadorian state was to regulate both sectors and set the electricity tariff, but not to be involved in electricity generation, transmission or distribution, nor in telecommunications provision. This was meant to usher in a new open, efficient and competitive era, and attract investment to expand both sectors. The state electricity monopoly Inecel was broken into five generation companies, one transmission company, and 18 distribution companies, all intended for sale. The central government, through the Solidarity Fund, was the major shareholder, with 100% of both telecommunications companies, 100% of the generation and transmission companies, and almost 100% of the distribution companies. The remaining shares are held by 'sectional' (local, municipal and provincial) governments.

In August 1996 the first attempt to partially privatise the telecommunications companies took place. 35% of Andinatel and Pacifictel were to be auctioned in a process led by Conam.[114] Several international operators expressed interest. But the bidding process was delayed several times. The state telecommunications monopoly Emetel was split into two companies, Andinatel and Pacifictel. In November 1997, six international operators were interested—but dropped out one by one. In December 1997, the sole remaining bidder Telefónica withdrew at the last minute. In April 1998, the auction was again cancelled when it emerged that, this time, Korea Telecom was the only bidder.[115] In 1999 a 'special advertising feature' in the *Washington Times* announced, "Ecuador is ready for privatization, and this time they are serious."[116] Following the unsuccessful attempts to sell minority shares of Pacifictel and Andinatel, reformers planned to sell 51% of each in September 1999. But in June 1999, Congress rejected a bill allowing the government to sell majority shares and the sale was postponed again.[117]

In the 2000 agreement, the Ecuadorian government proposed—again—to privatise telecommunications and electricity. Although originally the enabling legislation was not going to be reintroduced to Congress until 2001,[118] after the crisis in late 1999 there appeared a short window of legislative willingness. In March 2000

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[113] Vidaeus (2001).
[114] US and Foreign Commercial Service (1997).
[115] *World Telecoms Online* (2000).
[116] *Washington Times* (1999).
[117] *World Telecoms Online* (2000).
[118] Vidaeus (2001).

the Economic Transformation Law ('Trole I') passed, finally allowing the private sector to own a majority share instead of only 35%, and also eliminating the exclusivity arrangements for basic telecommunications services.[119] The sale of Andinatel and Pacifictel was announced again. Conam President Ricardo Noboa predicted utility privatisations would be completed by July or August 2001,[120] and a four-year World Bank/Conam telecommunications and electricity privatisation project began.[121] But the telecommunications sales were delayed first until December 2001—when Andinatel and Pacifictel lost their exclusive rights to provide fixed line and other services in Ecuador and thus became even less attractive privatisation prospects—and then throughout 2002. Meanwhile, four attempts at privatising the electricity distribution companies failed in 2001, and in a major blow, in late 2001 electricity privatisations were declared unconstitutional by the Constitutional Tribunal.[122] The government proceeded with the sales regardless, under threats of personal prosecution.[123]

In early 2002 Ecuador suffered three major privatisation failures. Over March and April, plans to sell majority shares in the distribution companies collapsed because of opposition from local councils, labour unions, and juridical insecurity.[124] The government tried a new strategy, to secure private administration instead of privatising, but this failed in both sectors. In May 2002, the three potential bidders for a $130 million concession to run Ecuador's biggest distributor, Emelec, all failed to finish the process.[125] In June, the attempt to secure private administration for Pacifictel failed. Conam again predicted that Pacifictel, Andinatel and some electricity distributors would be concessioned before December 2002, but again, this came to nothing.[126]

In the 2003 standby arrangement, Ecuador committed to contracting international management contracts (later revised to private, but not necessarily international) for the utilities by June (2003). Seven companies formally expressed interest.[127] However, although the IMF required concessions before the end of August,

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[119] Durand (2001).
[120] *BBC Monitoring International Reports* (2000).
[121] Vidaeus (2001).
[122] Hedgecoe (2002).
[123] *Spanish Newswire Services* (2002).
[124] *Electric Utility Week* (2002a).
[125] Moss (2002c).
[126] *Ibid.*
[127] *Global News Analysis* (2003).

the Solidarity Fund planned to *open* bidding on 31 August. Even if all went to plan, the management contract would not be awarded until 17 September.[128] This manifest incapacity and lack of will was a major factor in the breakdown of the 2003 agreement. The process to privately administer the utilities was eventually abandoned at the beginning of 2004.[129] An epilogue: in 2005 the *Ley Topo* (see Chapter Two) attempted to increase private investment in the electricity and telecommunications sectors but again failed to pass Congress.

Why they failed

Many commentators and Ecuadorian officials ascribe these failures to 'lack of investor interest', a function of inflated reserve prices.[130] So, for example, the telecommunications privatisation in 1998 was said to be cancelled because Korea Telecom was the only investor prepared to meet the base price of $2000/line—a high price compared to other Latin American countries, according to a World Bank study, given the requirements to invest substantially and to maintain initial low prices, the domestic and international instability, and the minority share on offer.[131] It was also said that with such a small prize—the second smallest telecommunications market in the Andean region—the effort might not have been worth it.[132] Additionally, the timing was bad: sales were attempted during a period of heightened instability (due to the banking and currency crisis and the *coup d'état*), new competition from mobile phone companies, the Argentinean economic crisis and the Californian electricity crisis. Finally, for both sectors, there was a generally hostile environment to foreign business, including negative public opinion and juridical and policy instability.

But most of these unattractive aspects have political roots, and some were created by veto players. Firstly, some experts in the energy sector felt the government's efforts to publicise the auctions were poor, revealing a lack of capacity or commitment to the reforms. Secondly, investors were not scared off by general juridical and policy insecurity, but by specific problems which arose during the bidding process. A significant contributing factor to the failed sales in early 2002 was Noboa's unexpected electricity tariff freeze. Bidders had planned on increases to

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[128] *Financial Times* (2003).
[129] *Global News Analysis* (2003).
[130] For example: *Privatisation International* (1999).
[131] *Washington Times* (1999).Vidaeus (2001).
[132] EIU (2005c).

allow them to achieve profitability. As well as preventing this, Noboa's interference also damaged investors' confidence in policy stability, according to international industry press (which called it 'an action with questionable legality').[133] Thirdly, the valuations of the monopolies were political. Initial Solidarity Fund studies which recommended that all twenty distribution companies could be reduced to four or five were later overruled, and just two companies were offered for sale.[134] The reasons given publicly for this involved economies of scale; the Ecuadorian market was said to be too small for more than two companies. However, some allege that the pressure to create only two companies came from those who intended to buy the companies at a lower price and also preferred a duopoly.[135] As it turned out, these attempts to lower the price were *too* successful, and the 'fire sale' price fuelled anti-privatisation rhetoric. The valuation of the telecommunications companies was also intensely political. Private consultants valued Emetel at $1.5 billion in 1997.[136] President Bucaram, however, announced that Pacifictel and Andinatel were worth $3 billion and that whoever sold them for less was a 'traitor' to the country.[137] Accordingly, in 1997, the price tag attached to just 35% of Emetel (that is, the state company before its division into Pacifictel and Andinatel) was $1.825 billion.[138]

This valuation has its ultimate roots in popular opposition to privatisation, arising from Ecuador's history. Ecuador's state institutions were developed while oil boomed during the military dictatorship (1972-1978), when development theory centred on national planning and state-led initiatives. The oil boom transformed Ecuador. With the state suddenly rich, there were ample funds to pay off rent-seekers. New vested interests were created as a middle class and bureaucracy emerged—especially in Quito—and developed ways to live off state rents. Ecuadorians grew to view state services as a right of citizenship, representing their share of the new oil wealth. Many state institutions later targeted for privatisation were established during the military era: Inecel (electricity), Emetel (telecommunications) and Cepe (oil). Most Ecuadorians continue to view state utilities as an integral part of a modern state. There has been mass opposition to the loss of state ownership, even where the utility

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[133] *Electric Utility Week* (2002a).
[134] Interview, senior official, Quito 2005.
[135] Interview, senior official involved with the privatisations, Quito 2005.
[136] US&FCS (1997).
[137] Interview, Andres Perez, former President of Andinatel, 14 April 2005, 3pm, Quito.
[138] *Business News Americas* (1997). Even by 2000, a study valued Andinatel at only $600-700 million (*Business News Americas* 2000a).

will clearly continue to provide the same services in the same location.[139] Moreover, although more educated sections of the population have tended to support privatisation, in the early 2000s it began to fall out of favour even with them, as examples of radical reform without subsequent growth emerged from the rest of Latin America (especially Argentina).[140] Ecuador acquired reform fatigue without having reformed.

All this underpins the executive's refusal or inability to undertake any of three options which would improve the sector: to raise the end-user tariff, to sell *or* invest in the distribution and generation companies, or to guarantee private generators will be paid. The biggest of these problems is the tariff, which is set below the cost of production. In theory an independent government watchdog (Conelec) establishes a theoretical price an efficient company would attain, from which is derived a 'referential generation price' imposed on generators. The tariff is meant to equal the sum of generation, transmission and distribution costs. In practice, however, it is politically difficult to raise the end-user tariff. Virtually every president since 1990 has tried to raise the tariff and has backed down in the face of major, multi-day strikes and protests on essential services. For two presidents, attempting energy price rises significantly contributed to their premature departure from office.[141] Only Alarcón was not faced with massive protests; he was the only president not to try to increase prices. Conelec's findings are now simply overruled by the Presidency. For 2005, Conelec declared the efficient generation price at 5.2 cents per KWH but the Presidency set it at 4.16 cents per KWH. Discrepancies add up, so the final tariff (10.6 cents per KWH) is well below marginal production cost (8.6 cents per KWH). The deficit thus continually increases.[142]

The inadequacy of the tariff affects the whole sector. The tariff does not cover distributors' costs, so the distributors cannot pay the generators. Thus generation cannot be privatised before distribution is. There is also no incentive to invest in generation. State-subsidised diesel fuel for state-owned thermoelectric generators

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[139] For example, the sale of the Cement company of Chimborazo. Opinion polls have consistently shown that Ecuadorians do not generally want to privatise. A poll in 2002 by Cedatos, an Ecuadorian polling firm, showed 71% opposition to privatising the distribution companies (*EIU Business Latin America* 2002).

[140] Interviews, Quito 2005.

[141] In the case of Bucaram, the straw that broke the camel's back was his attempt to raise the tariffs on electricity and LPG prices. For Mahuad, it contributed.

[142] Interviews, past and present energy sector officials and ministers, Quito, 2005.

allows inefficient generators to leap-frog more efficient private producers in supplying power to the national grid.[143] Because private investors are reluctant to invest in the sector, and also because the public utilities continually run losses and are therefore unable (and unwilling) to invest, the national generation facilities have become ever more obsolete and inefficient. This makes generation more expensive, exacerbating the problems of the tariff deficit and of collection by distribution companies. In short, the political economy of the electricity industry is deeply unattractive to new entrants.

Privatisation was fiercely opposed by actors who benefit from these inefficiencies, and have a strong interest in maintaining them. A variety of actors (unions, political parties, private businesses and individuals, management) harnessed a variety of tools (the courts, public protest, intimidation, Congress). In particular, three players had the ability to credibly threaten the government over the privatisations: unions, management, and (although evidence is less clear) private business interests. Unions worked through Congress, sectional government and the Constitutional Tribunal, management and private business interests through Congress and directly on the executive. I discuss first unions and management, then private business interests.

Since any sale concerns two parties—buyer and seller—a player who can credibly threaten either has a veto. The unions were able to threaten *both* with losses of power: policymakers feared angering them, and foreign bidders feared losing control or ownership of their purchases in the medium and long term. Workers had reason to veto, since they benefit from inefficiencies within the sector (especially those arising from state ownership). Firstly, candidates promise during electoral campaigns that they will increase jobs, and expanding the public sector is an easy way of doing so. Continual staff increases reduce the workload for existing staff.[144] Secondly, political appointments have been extremely common in both the electricity and telecommunications sectors.[145] The promise of lucrative jobs for specific

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[143] This practice was the subject of a complaint by a 'more efficient gas turbine electric producer' to a US House of Representatives hearing on Ecuadorian trade disputes in 2004 (US House of Representatives 2004).

[144] Minister of Energy Pablo Terán estimated most of the publicly-owned energy sector companies could operate with 50% less staff. Interview, 22 March 2005, 11am, Quito.

[145] This politicisation stretches past the policy-making and high administrative levels to encompass general staff. Interviewees who had run state agencies concurred that in some, only the 'technical' layer is apolitical.

individuals attracts campaign workers, and successful candidates must reward their followers. Management positions are used to pay political favours, and political forces, having assumed these positions, pay their own debts by hiring others.[146] Thirdly, public sector union members have many more benefits than their private sector counterparts. Under the Quito electricity distributor's (EEQ) collective contracts, for example, workers receive free electricity, foreign medical insurance, myriad bonuses including a 'birthday bonus', and unusually high job security (including up to seven years' salary for dismissal).[147] For some time there were even hereditary positions; some workers *inherited* their jobs regardless of skills or qualifications.[148] Because these privileges are directly related to state ownership, existing workers have an enormous incentive to fight to preserve the status quo.[149] Similarly, they have no incentive to support a tariff increase. Politicised staffing is inefficient, but its economic effect is masked because the companies can always blame their poor performance on the inadequacy of the tariff.[150] The state has always been willing to bail state-owned generators out, so the sector's inefficiency does not concern them. In fact, raising the tariff would be the first step towards a transparency which would probably erode worker privileges.

The workers in these industries have three powerful tools: votes, protests, and strikes. The first two are significant, and the third, stopping essential services, is a devastating political threat. The state-owned candidates for privatisation operate in crucial sectors, because it was the state that originally developed strategic infrastructure. These unions have veto power because they can quite conceivably bring down the government. As a former Minister of Energy said, "If EEQ cuts electricity you are in serious problems. If Petroecuador stops pumping oil from the Amazon, the government falls! When I was Minister they tried to stop providing gas. Two days without providing gas to the cities and you stop the country."[151] Despite the

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[146] As one interviewee said, "Here in Ecuador to be the manager of the electricity company is like being a policeman, priest or whatever, it's powerful." Interview, Verónica Lojan, MEF official, Quito, 12 April 2005, 9am.

[147] Interviews, Ministers of Energy, Quito 2005.

[148] Interview, Pablo Terán, former Minister of Energy, 22 March 2005, 11am, Quito. Arteta and Hurtado point to a similar hereditary right to civil service positions in the IESS (2005: 192).

[149] Of course, private sector companies are not free of corrupt or monopolistic practices either.

[150] Interview, high level energy official, Quito 2005.

[151] Interview, Pablo Terán, former Minister of Energy, 22 March 2005, 11am, Quito: "The difficult ones are the ones who control some sort of service or utility. Gas stations, for example. I started controlling the quality of the gas. They almost wanted to kill me. They decided to stop selling fuel for a day. *That* is powerful."

constitutional ban on striking on strategic services, public sector unions have discovered they can strike with impunity since they are so numerous. The central role of the state in this can be seen in the weakening of unions in sectors which have diversified, such as in oil. Before 2002, the Petroecuador union's main weapon was the SOTE, Ecuador's only pipeline. Striking was as simple as shutting the valve, an action which caused immense damage to oil infrastructure. Now that oil can also be transported through the OCP—a private concern—the Petroecuador union has less leverage.

Unions set about demonstrating their veto power to state and foreign decision-makers. They mounted a major public opinion campaign, emphasising that state resources would be sold to foreigners. There were strikes throughout the privatisation processes and the unions also worked behind the scenes to undermine the government negotiations.[152] Following one strike by electricity workers, the government was forced to ration electricity.[153] The strength of unions' opposition scared off many of the private companies originally interested in participating. In particular, unions used their influence in three state institutions: sectional governments and then in Congress, where it was eventually transmitted to the Constitutional Tribunal. The electricity privatisations suffered a major setback when the Tribunal suggested they might be unconstitutional, implying that if the sale were challenged, privatised assets might be seized.[154] Telecommunications unions used a similar appeal to the Constitutional Tribunal to dissuade bidders.[155] The legal consensus seems to be that the arguments relied upon by the Constitutional Tribunal were tenuous, and a former Minister of Energy claimed 'unconstitutionality' was a mere pretext.[156] Indeed, article 249 of the Constitution of Ecuador provides that:

> "The provision of public services of potable water, irrigation, drains, *electricity*, *telecommunications*, roads, port facilities and others of a similar nature will be the responsibility of the state. *The state may provide these*

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[152] Interview, former Minister of Energy, Quito, April 2005.
[153] EIU (1997).
[154] *EIU Business Latin America* (2002).
[155] In November 2003 several companies were initially interested in bidding. However, workers in Andinatel filed a case with a Quito court (Alvaro 2003) and then appealed against the Solidarity Fund to the Constitutional Tribunal on the grounds that contracting international administration was unconstitutional. By the time the Tribunal considered the case, the process had been cancelled by the Solidarity Fund and the Tribunal decided to issue no ruling as the matter was now irrelevant (Bohórquez 2004).
[156] Interview, Galo Abril, former Minister of Energy, Quito, 1 April 2005, 4pm.

directly or by delegation to private or mixed businesses by means of concession, association, capitalisation, sale of share capital, or any other contractual form in accordance with the law." [Italics added]

The small community of energy industry technocrats had an alternative discourse justifying the reforms (the need for foreign capital to invest, and the exhaustion of the model of aid for state infrastructure), but government officials chose not to mount a strong response in Congress and the arguments were barely made.[157] The foreign companies withdrew, scared to invest while the constitutionality of the process was questioned. Most of the bidders were not already operating in Ecuador and had low barriers to exit.

Workers and management also had influence in the sectional governments, some of which were institutional veto players. In some electricity companies, even though the Solidarity Fund is the majority shareholder, the real control is by the sectional governments. Most distribution companies are only owned 51% by the Solidarity Fund, with the sectional governments owning the other 49%. In two companies, in Riobamba and Azuayas, the sectional governments hold the majority and the Solidarity Fund could not reform against their wishes. In sixteen distribution companies, the Solidarity Fund has a nominal majority. However, in Quito, a statutory provision requires sectional government approval for important decisions. Quito is a stronghold of the union party, the ID, which opposed privatisation. When Quito vetoed the sale of EEQ, by far the biggest of the distributors, Noboa cancelled the sale of all distributors in the sierra and Amazon in a "brief and angry" press conference.[158] Soon after, following months of rumours, the government also cancelled the sale of the seven coastal electricity companies when the companies qualified to bid withdrew.[159]

The sectional governments' position was influenced not only by the unions but also by the sectional governments' own interest in the utilities. The plans to contract private administration (the strategy attempted in 2004) originally called for merging local companies into regional centres. But powerful regional actors (mayors, provincial prefects, members of congress) would lose out from 'regional

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[157] Interview, Donald Castillo, President of National Electricity Council and former Minister of Energy, 6 April 2005, 11am.
[158] *Electric Utility Week* (2002b), *EIU Business Latin America* (2002).
[159] Hedgecoe (2002).

centralisation' and so opposed the reforms, using 'regionalist' rhetoric which mobilised popular opinion.[160] Thus when the Solidarity Fund attempted to pass a resolution through each of the 16 companies in which it had a majority on the Board of Directors, four successfully argued that private administration was inappropriate for their particular circumstances and one of these, the province of Cotopaxi, backed up the argument with a paralysing general strike. Meanwhile, the coastal political parties applied strong pressure on the President to abandon privatisation. The process of contracting temporary private administration thus involved just twelve small companies,[161] and failed to attract interest.

Although hard evidence is difficult to gather, there was general agreement from those who knew the electricity and telecommunications sectors intimately that private business interests were also a veto player. Their motivation arises from three factors. Firstly, for well-connected businesses, lucrative contracts depend on the politicisation of utilities. One former Minister of Energy interviewed gave two examples:

1. A business selling primitive motors for electricity generation would lose its market when private owners of generation companies invested in new technology instead. This business was tightly linked to a member of Congress, who therefore worked to ensure the reforms failed.

2. A manufacturer of telecommunications equipment had lucrative contracts with Andinatel and Pacifictel which would probably be lost after privatisation. The business was linked to the two members of Congress who sought the declaration of unconstitutionality during the telecommunications privatisation process.

Secondly, if state businesses are inefficient they cannot compete with private businesses, who thus prosper. Allegedly, the owners of such private businesses

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[160] The sectional governments were successful in insisting that the administration should be allowed to be national as well as international. The unions remained opposed to the reform, arguing that the administration would be captured by national oligarchy. Interview, Leonardo Zaragocin, Manager of State-owned Utilities (Solidarity Fund), Quito, 14 April 2005, 9am.

[161] Covering only 30% of the electricity market, according to Solidarity Fund papers shown to me in the above interview.

actively seek to keep the state companies weak.[162] All the credible bidders throughout the privatisation processes were foreign businesses, so Ecuadorian private interests would have been exposed to global competition if privatisation had succeeded. Thirdly, state ownership of utilities helps well-connected businesses evade bills. In both electricity and telecommunications, many known debts go uncollected. In the electricity sector, 'technical' losses (transmission inefficiencies that can never be completely eliminated) are dwarfed by 'non-technical' losses (that is, stolen electricity through unauthorised and unnoticed connections, altering meter readings, and unpaid debts). In 2003, 13.74% of all electricity generated became non-technical losses. It is impossible to ascertain the relative significance of each of the three forms (unauthorised connections, altered meters, unpaid debts); the debtors are known, but never made public.[163] However, figures published show a huge difference between the non-technical losses suffered by different distribution companies. Non-technical losses are statistically associated with the Coast, and politically associated with the parties who represent the Coast in Congress. In coastal Manabí 32% is lost, in Quito only 14%.[164] Fernando Bustamante, Professor of Political Science in Quito, illustrates the system:

> "If you want to collect those debts, you will get a phone call from the mayor, or the President, or the Minister, and they will say, 'What are you doing? Stop it! These people are important to me, leave them alone!' They can even resist debt collection, with armed guards and so on. It has been done. They will just receive the debt collectors at gunpoint, and there's nothing you can do."

When utilities do not collect debts, this subsidises politically well-connected private business. But they can only use their political clout to avoid paying utility charges if the state controls the utilities. There is thus a strong financial motivation to oppose privatisation.

The situation is similar in telecommunications. The last attempt to sell any of the telecommunications companies occurred in 1998. According to multiple sources,

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[162] Interview, former Minister, Quito 2005.
[163] According to one interviewee's estimate, some 30% of debts in Guayaquil are never paid. These bad debts, moreover, are said by several energy sector policymakers to be concentrated among the largest consumers of electricity.
[164] Oleas (2004b:20).

this sale was prevented by a powerful family with interests and political influence not only in the state-owned telephone companies but also over the regulator, the Superintendent of Telecommunications. The family was concerned it would lose its privileged monopoly position and so—allegedly—arranged for a well-connected politician to publicly threaten that the deal would be withdrawn. As a result, the sole bidder withdrew at the last minute.[165] There are similar stories regarding other potential bidders at various stages. For example, when the government attempted to offer international telecommunications concessions, two companies submitted bids by the deadline but both then withdrew citing legal concerns. This was because an Ecuadorian company 'Telefecom' had filed a lawsuit five days earlier, alleging 'irregularities' in the process.[166] Former Solidarity Fund President Alejandro Rivadeneira alleged the lawsuit was just a strategy to disrupt the auction, noting that Telefecom was worth only $800, had no assets or experience to warrant a bid, and had spent $50,000 on advertising opposing the process. Rivadeneira said Telefecom was backed by economic interests opposed to the privatisation, including politicians who receive campaign funding from Pacifictel suppliers with lucrative contracts. The day after the auction failed, the lawsuit was thrown out.[167]

The flip side of vested interests' influence over state institutions is institutional and executive weakness. Both the Solidarity Fund and Conam, the institutions handling the reforms, were suffering from institutional incapacity, especially among their leadership.[168] The task of contracting international administration was given to Conam for some months, but Conam did not make much progress on implementation and it was then given to the Solidarity Fund. There, too, despite pressure from the MEF, progress was slow and the process inefficient. Insiders felt that the presence of vested interests and their relationship to the political appointees then in control of the Solidarity Fund were key factors. Economy Minister Pozo, among others, claimed that the President's political commitments in the Solidarity Fund—an institution in theory controlled absolutely by the executive—had blocked the process to contract international administration for the electricity companies.[169] Changes in congressional

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[165] Based on several interviews, including one eyewitness to events.
[166] Business News Americas (2002), IACHR (2005).
[167] Business News Americas (2002).
[168] The causes of this are discussed in Chapter Six.
[169] Interview, Mauricio Pozo, former Minister of Economy, 21 March 2005, 4pm: "At the end of the day it was impossible. I don't know why. I pushed to the President every day for that. He told me, listen, the guy who is in the Solidarity Fund—the entity that managed the electricity companies and

coalitions also delayed reforms. In late 2004, emergency small-scale reforms in electricity were voted down when relations between Gutiérrez and PSC leader Febres Cordero soured at the last minute. The week before the legislation was due in Congress, the President of the Commission, a member of the PSC, refused to sign the final version, although he had previously supported it. Gutiérrez had changed one provision: the administration of the distribution company in Manabí (the province with the highest 'non-technical losses'). The PSC member's refusal was interpreted as arising from his close relationship with those who would have controlled the administration in the original version.[170]

Because the executive knew it lacked political capital for all the planned reforms, after 2000 a conscious decision was made to sacrifice telecommunications in favour of electricity, a harder but more economically significant reform. Noboa's prioritisation of electricity was evident from the beginning of his administration, when he sought congressional support. From the PSC, Noboa asked for support for only two things: dollarisation—which the PSC agreed with anyway—and electricity reform.[171] The PSC agreed to allow the government to privatise 51% of electricity utilities in exchange for (allegedly) concessions on public contracts to the mayor of Guayaquil (then PSC leader Febres Cordero) and several other concessions including some related to debts from failed banks... and the sacrifice of Pacifictel, the coastal telecommunications monopoly. [172] The coastal political forces opposed to the modernisation of Pacifictel had to be pacified for electricity reform to have a chance.

We can see the effect of this on Pacifictel by comparing it to its sierran counterpart, Andinatel. Andinatel is an excellent counterfactual, since like Pacifictel it emerged from state monopoly Emetel. Emetel split into two similarly-sized companies: Pacifictel with 655,189 lines, Andinatel with 579,535. [173] But each developed quite differently. By 2003 Andinatel had reduced its staff from 3200 to 2500 and almost doubled its fixed lines, while Pacifictel had hardly grown. Interviewees called Pacifictel a "mess", a "disaster", a "disgrace", politicised at every

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some others—is a good guy, he's going to follow you. But I told him many times, he is not following me, he's going a different way...Gutiérrez had general commitment to the programme, but this was an example of somewhere where he didn't have commitment."

[170] Interview, senior official in Gutiérrez administration, Quito, 2005.

[171] Interview, former member of Congress.

[172] Interviews with former Minister and two former state officials, Quito 2005.

[173] Tangeman (1998).

level and notoriously corrupt.[174] In 2005 a US State Department Report found that "Pacifictel has faced severe management challenges for the last few years, and continues to struggle to stay afloat. The company has been the focus of several scandals and has experienced frequent management changes.[175] For the entire period 2000-2005 Pacifictel made losses, and by 2005 was near bankruptcy.[176] Major contracts, sometimes worth hundreds of millions of dollars, were and still are awarded with little or no transparency and are routinely subject to direct political interference. In 2004 a $4.6 million contract was awarded to an insurance company not authorised by the Superintendency of Banks.[177] Andinatel, in contrast, developed a set of purchasing regulations and safeguards, decreased Emetel's two-year wait for a new fixed line to 24 hours,[178] expanded services, and steadily increased profits until by 2004 it was contributing 93% of total Solidarity Fund profit.[179] The relationship between Pacifictel and Andinatel became increasingly strained, as they were forced to work together on issues such as the regional interconnection, international calls and joint government projects like fibre optics and mobile telephones. Pacifictel's debts to Andinatel grew and Andinatel eventually took over some joint projects altogether.[180]

Andinatel and Pacifictel's different trajectory was due to political protection on one hand, and sacrifice on the other. Noboa's Vice-President Pedro Pinto was committed to preventing political interference in Andinatel. In anticipation of privatisation, Pinto ensured several political appointments to Andinatel's Board were replaced by apolitical businesspeople and lawyers, who then dismissed many middle managers and hired new executives using international head-hunters.[181] When existing workers opposed change, the new management invested substantially in retraining and establishing a service culture.[182] Additionally, Pinto provided political protection from Congress. As they had been accustomed to doing in the days of Emetel, legislators attempted to make appointments with Andinatel's Executive

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[174] Interviews with state sector officials, economic policy makers, private businesspeople, Washington and Quito 2005.
[175] US Department of State (2005).
[176] *Business News Americas* (2005b), *El Comercio* (2005e).
[177] *El Comercio* (2004d).
[178] A former employee recalled that one of the biggest problems was that when Andinatel engineers arrived to install new lines, householders would refuse them entry, thinking they were thieves.
[179] *Business News Americas* (2005a).
[180] Interview, Andres Perez, former President of Andinatel, 14 April 2005, 3pm, Quito.
[181] *Washington Times* (1999).
[182] Interview, Andres Perez, former President of Andinatel: "They were used to working badly, working little, being corrupt. Giving out lines was a great business. Selling a line and keeping the money personally..."

President in order to request political favours. With Pinto's support, however, the Andinatel President was able to deny these requests, later recalling, "Finally they got tired of trying and they didn't come back. They discovered it wasn't their place."[183]

The modernisation of Andinatel avoided inflaming the key veto group in the sierra—unions and left-wing groups—since reformers attempted a culture change, rather than dismissing all the staff. However, on the coast this approach would have attracted opposition from the business groups who profited from Pacifictel's inefficiencies. The point is that these groups are also the key collective veto player for coastal reforms in the electricity sector. It was thought that if the electricity companies were to be sold, these groups needed to be placated. Thus Pinto's good friend Ricardo Noboa, head of Conam, took responsibility for Pacifictel. He named a series of Pacifictel directors from powerful coastal groups related to the PSC, effectively handing control of Pacifictel to these groups.[184]

Discussion

This section has introduced several complexities. Ecuador's inefficient electricity and telecommunications sectors generate strong vested interests with the power to protect their rents. In 2000, the reforms were vetoed by different groups in different parts of the country, by groups which used a variety of methods, including different institutions. Some had clear and explicit vetoes (the Quito city council refusing to sell), some used their veto by working inside the state apparatus (powerful business groups), some merely threatened to veto (the constitutional tribunal), and some used dissuasion backed by implicit threat of veto (the union strikes, which raised the risk and lowered the price investors were willing to pay below what was being offered). Unions could credibly threaten by striking, or by using their representation in Congress and sectional government (backed up by strikes) and in the Constitutional Tribunal, appeal to which can veto directly and also create uncertainty to dissuade foreign investment. In 2003, fulfilling the IMF conditions (contracting international administration) required no legislation in Congress. As in the case of customs, veto players instead worked on the executive, successfully undermining the process through a series of 'delays'.

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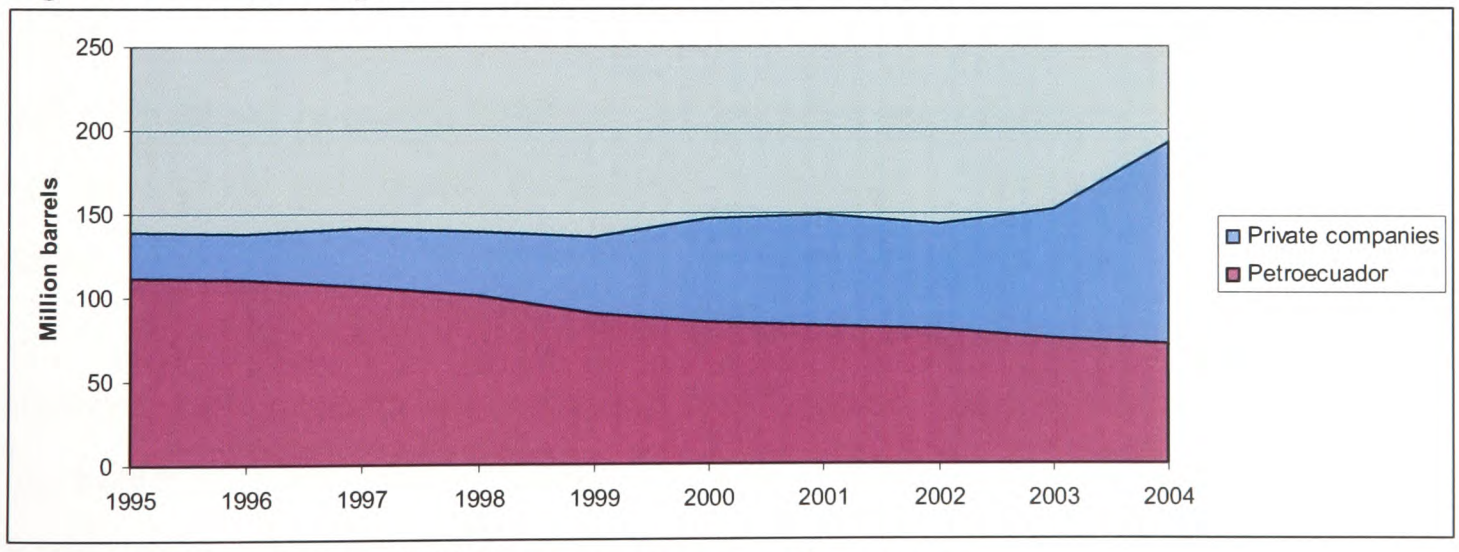
[183] Interview, Andres Perez, former President of Andinatel, 14 April 2005, 3pm Quito.
[184] Interviews, former member of Congress and former state official.

This section also demonstrated the political underpinnings of the sectors' 'unattractiveness'. Few investors were prepared to bid because years of politicised, inefficient management had eroded the enterprises; because the sectors remained politicised and the valuations bore little relation to the enterprises' real value; and because of the policy, labour and juridical instability which became obvious during the privatisation process. Finally, we saw how reforms were traded off. Noboa sacrificed an easier but less important reform for a harder but more economically significant one; a high risk/return strategy which failed to deliver any results. The divergent evolution of Pacifictel and Andinatel illustrates the debilitating effects.

Oil sector

Oil is Ecuador's most important industry, accounting for one-fifth of GDP and 44% of exports in 2001.[185] However, the sector has major production problems: low state production, an inability to translate production into profit, and constrained private production. State company Petroecuador's oil production has fallen every year since 1994 (see figure 3.4), due to inadequate investment in maintenance—even though Petroecuador operates 90% of known reserves, the best in Ecuador. Petroecuador's virtual monopoly over the fields of highest yield has crowded out private investment, forcing private firms to operate in the fields of unproven quality and quantity.[186]

Figure 3.4: Annual petroleum production in Ecuador

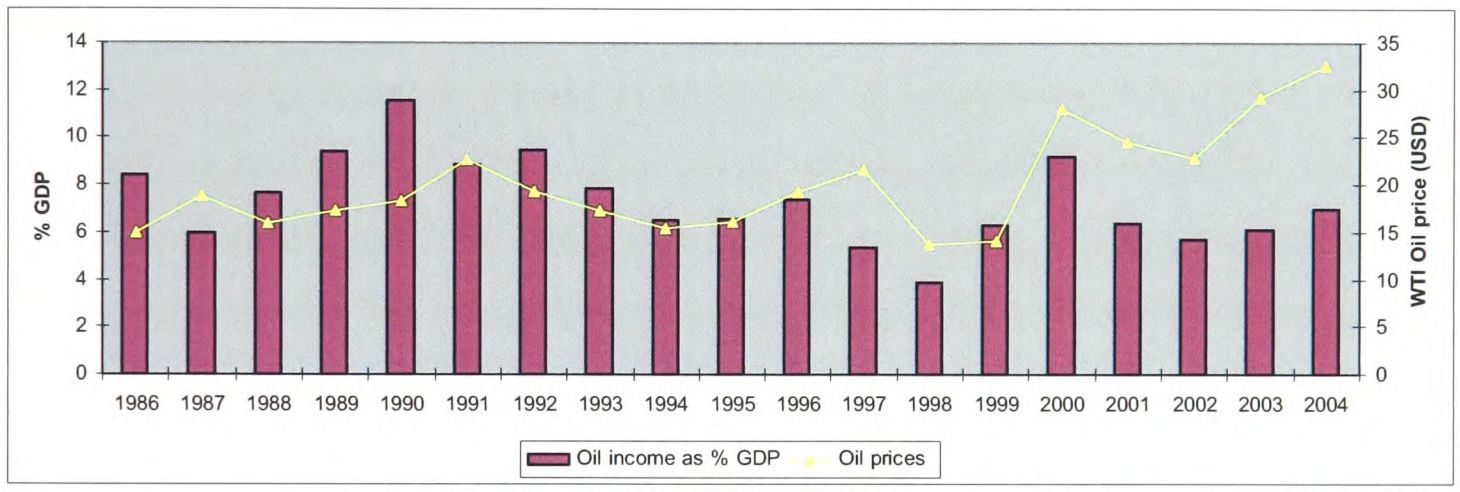


Source: Petroecuador (2005), www.petroecuador.com.ec.

[185] Babelon and Dahan (2003).
[186] *Alexander's Gas and Oil Connections* (2004).

The second problem is an inability to translate production into profit. As figure 3.5 shows, despite historically high oil prices since 2002, oil *income* has barely increased. One unpublished study of the sector revealed that the difference between the value of barrels extracted annually by Petroecuador, and Petroecuador's annual revenue, approached $1.5 billion a year (equivalent to almost 20% of total government revenue). Operating costs cannot conceivably account for this gap, as Petroecuador invests very little in maintenance. Instead, most of the gap is thought to represent corruption, inefficiency, and implicit subsidies. As oil prices have more than doubled since this study, the gap is probably much wider today.[187]

Figure 3.5: Oil prices and oil income as a percentage of GDP



Sources: Central Bank of Ecuador (2005) 'Operaciones del Sector Publico No Financiero', www.bce.fin.ec; US Energy Information Agency Cushing, OK WTI Spot Price FOB (Dollars per Barrel), www.eia.doe.gov.[188]

As public production has fallen, private production has risen (see figure 3.4). It could rise more; currently private companies have only limited rights of exploration and exploitation in certain fields and are banned from commercialisation activities.[189] For Ecuadorian technocrats, the solution is obvious: a 'demonopolisation' of the oil sector.

However, reform attempts have failed repeatedly. For the last fifteen years, no significant oil contracts have been signed in Ecuador. The last major round was under the Febres Cordero administration (1984-88). Febres Cordero's successor, Rodrigo Borja, was a nationalist who, on assuming office, cancelled the contracts awaiting a

[187] Interviews, senior MEF and IMF officials, Washington and Quito 2005.
[188] Average for whole year, calculated from daily oil prices.
[189] For example, only Petroecuador may import gasoline into Ecuador. Private companies are restricted to buying gasoline from Petroecuador, the sole producer of gasoline, and selling it within Ecuador at the same price as the competition. Interview, Manuel Echeverría, former President of Petroecuador, 13 April 2005, 8am, Quito.

signature.[190] Borja also chose not to renew the contract with Texaco—the last remaining oil major in Ecuador—and Texaco's fields passed to Petroecuador. The Durán Ballén administration signed only contracts for marginal fields. Then Bucaram was in office for just six months and—whether through inclination or lack of time—signed no new contracts. Alarcón appointed as Energy Minister a former minister under Borja, Raul Baca, who did not attempt to sign new contracts. Mahuad was distracted by crisis, and new contracts were a low priority. Next, although the government of Noboa was not ideologically opposed to signing new oil contracts, political problems of short-term survival sapped scarce political capital (as we shall see, signing oil contracts tends to diminish popular support). The Gutiérrez administration attempted to offer new contracts but was unable to conduct a successful round.

Attempts to increase private participation in other ways also failed. In the April 2000 agreement, Ecuador committed to raising petroleum revenues, and the August supplement specified that this meant increasing private participation, including joint ventures in Petroecuador's major fields. This legislation was presented to Congress as the *Ley para la Promoción de la Inversion y la Participación Ciudadana* (Investment Promotion and Citizen Participation Law), nicknamed 'Trole II'. Trole II was voted down in Congress, vetoed and sent back by Noboa, and eventually entered into law only by default after the statutory period for consideration by Congress passed. Most members of Congress opposed the legislation, and failed to address it only because a several-fronted battle over naming a Speaker occupied all the legislature's time.[191] Opposition to Trole II was strong outside Congress, as unions, indigenous groups and environmentalists all promised protests and strikes.[192] When it passed by default, these social sectors appealed to the Constitutional Tribunal, which declared 41 of the 96 articles wholly or partly unconstitutional, including the joint venture provision which was key to planned investment in Ecuador's five largest fields.[193] Noboa's threat to impeach the Tribunal members if they ruled against the government, made before the decision was announced, appeared to make no

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[190] Interview, Fernando Santos, Minister of Energy under Febres Cordero, Quito, 5 April 2005, 11am.
[191] Congress even split in two at one point, meeting simultaneously in different chambers (*World Markets Analysis* 2000).
[192] *El Nuevo Herald* (2000).
[193] *Spanish Newswire Services* (2000b), *Spanish Newswire Services* (2000c).

difference to the outcome.[194] 2000's reform attempt therefore failed. In 2003 Ecuador committed to 'a fundamental restructuring of the petroleum sector'.[195] Authorities were to prepare a plan for improving oil production in Petroecuador, especially by increasing private sector participation in the state-run oilfields. An international audit was built into the conditionality for the third review, which never took place. An auctioning process began several times, but was never concluded. The failure of these reforms was a major reason for the premature termination of the 2003 agreement. Finally, an IMF-supported tendering process in March 2004 for 20-year contracts in four state-owned fields in the Amazon basin attracted little interest from private companies, and in April 2004 it was suspended.[196]

One factor in the inability of successive governments to conclude a new oil round is instability: each round takes two or three years and none of the five governments since Bucaram's election in 1996 has lasted this long. But the *main* reason Ecuador's oil sector has remained unreformed is because of rent-seeking groups. In Chapter One, it was noted that some players can develop a constituency and ultimately a veto by calling on 'big ideas' to mobilise masses. Let us first consider the ideational context and then examine veto players individually.

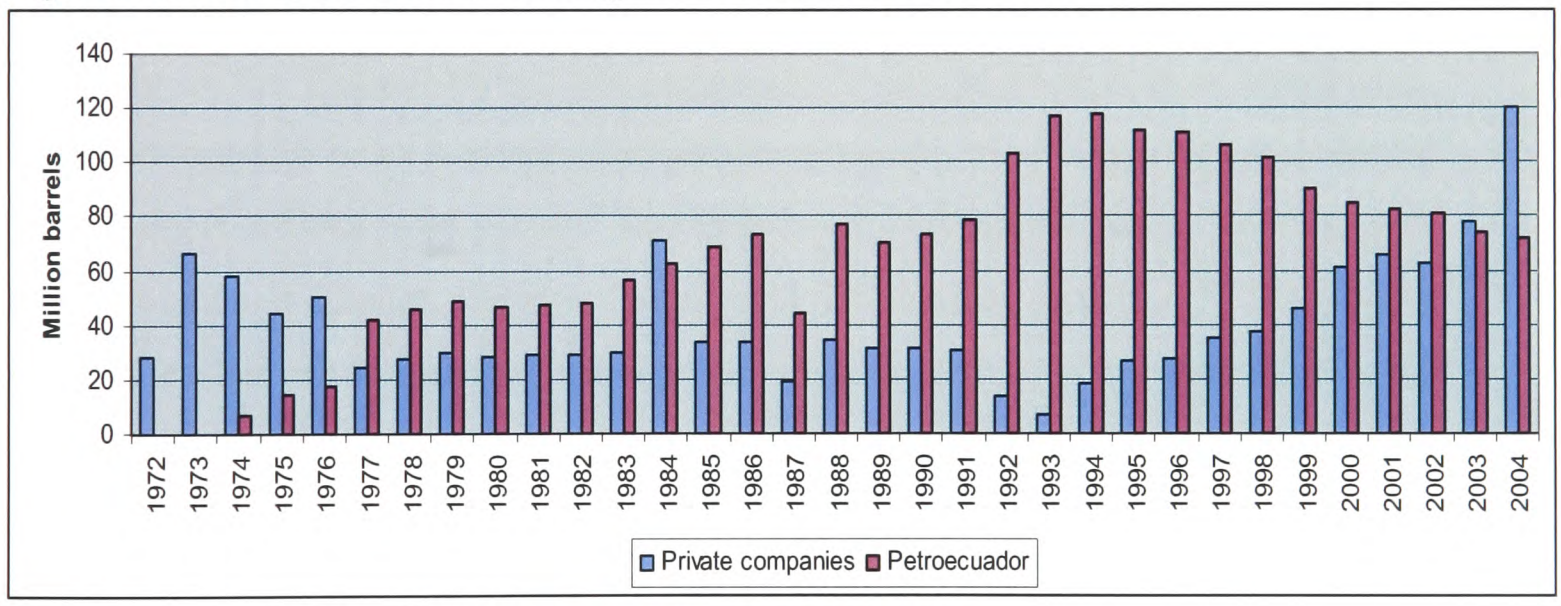
Veto power in the oil sector can only be understood with reference to its development with Petroecuador at its heart. Ecuador's oil sector developed in three main stages: a period of essentially free-market development by major foreign oil companies, military-led development of a national state company and restricted private participation, and, beginning a few years after democratisation, a slow return to private participation.[197] Figure 3.6 shows how state production grew to be much more important than private production before decreasing again. The key stage in the public consciousness was the middle period (1972-1978), when the military regime established the major state entities, including Petroecuador. The attitude of the military regime to foreign capital was highly influential in creating a public culture of antipathy to foreign investment in the oil sector. While oil boomed, the military used nationalist rhetoric to consolidate their grasp on power. Stories of corruption in the private oil sector all over the world were encouraged. The military investigated, reported and perhaps exaggerated the corruption that had previously existed in

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[194] *Latin America Weekly Report* (2000c).
[195] Government of Ecuador (2003b). See especially C:11.
[196] *Alexander's Gas and Oil Connections* (2004).
[197] Llanes (2004).

Ecuador's oil sector, such as the tale of the petroleum lawyer who needed an extra signatory and signed up a peddler woman he found on the street. Instead of seeing foreign oil companies as important importers of education, technology and capital, Ecuadorians were encouraged to see them as corrupt and exploitative of the Ecuadorian poor.[198] In this hostile climate, all the oil majors except Texaco (which operated particularly rich fields) left Ecuador. For many Ecuadorians, foreign capital—particularly Anglo-American capital—became synonymous with exploitation and domestic elite collaboration. In contrast, the Ecuadorian state, though seen as corrupt and occasionally repressive, was at least 'ours'. Commitment grew to a national oil company which would prioritise the interests of Ecuadorians. As Fernando Santos said, "In 1984 when I was Vice-Minister of Energy, Petroecuador was terrible. It was so corrupt. But we couldn't dissolve it because it would be like dissolving Congress or burning the flag—it was a cultural thing that, by then, you couldn't touch."[199]

Figure 3.6: Petroecuador's development and decline since 1972



Source: Petroecuador (2005), www.petroecuador.com.ec.

Petroecuador could neither be abolished nor substantially reformed. As it was functionally autonomous from the Ministry of Energy, it has proven easy for Petroecuador management to ignore or undermine the Minister's policies.[200] Petroecuador's Board comprises not only the Ministers of Economy and Industry, but

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[198] Interviews, Ministers of Energy, oil unionists, indigenous culture specialist (Conaie) and former President of Petroecuador, Quito 2003 and 2005. Also see Llanes (2004).

[199] Interview, Quito, 5 April 2005, 11am.

[200] One official in the energy sector who attended meetings in the 2000s recalled: "The management of Petroecuador did whatever they wanted. For example, they would ask the Board of Directors whether they could hire another 50 people, and the Board would say no and they would say, 'What a shame, because we've already done it.' "

also the Vice-President and representatives of the military, a hangover from military rule. Any project for reform must be approved by this group, and many also require Congressional approval. Many military personnel have retained the spirit of the military dictatorship, especially the antipathy to privatisation and orientation against foreign companies.[201] Industry insiders emphasised that it takes both political capital and personal presence to overcome the interests and influence of these military men.[202] As private involvement in the oil sector increases, the military loses influence; this is significant to the military on an individual basis and also because of the strategic importance of national control over oil.

Given this, energy sector policymakers have largely left Petroecuador to its own devices and concentrated on the other side of the equation: increasing private participation in exploration and extraction of oil. But this too is unpopular. Ecuador first experienced early foreign investment with little regard for environmental or labour concerns. In particular, the legacy of environmental damage arising from exploration by Texaco is well-known in Ecuador and held as an example of the threat from foreign oil companies. As environmental awareness grew in the 1970s, particularly in the United States, oil companies began to change their operations. Whether voluntarily or as a result of consumer pressure, they began to compete for 'environmental achievement awards' and developed new means of exploration with less environmental impact, such as the so-called 'invisible pipeline'.[203] But recent studies of earlier environmental damage are associated in the popular mind with current exploration, implying development in the south will damage the environment just as it has in the old Texaco blocks in the north. Additionally, the poor administration of the fund meant to ensure local communities benefit from oil exploration means these communities experience the downside of foreign oil capital without the promised upside.[204] Amazonian indigenous communities do experience a

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[201] Furthermore many former military officers are prominent in politics: Gutiérrez himself is the most well-known example, but there are others such as the Mayor of Quito, Paco Moncayo (2000- present).

[202] Interview, Fernando Santos, Minister of Energy under Febres Cordero, Quito, 5 April 2005, 11am: "With [President] Durán Ballen or with [President] Febres Cordero, men of great presence, the military men could be controlled. But with [Presidents] Mahuad or Alarcón…"

[203] Interview, Herb Vickers, General Manager, Burlington Resources Ecuador Limited (petroleum extraction company), 13 April 2005, 11am, Quito.

[204] The Amazon Development Tax is meant to distribute 50 cents per barrel extracted from the Amazon for local development. Based on the amount of oil exploration in the area, the fund should have distributed millions, but very little of the money has actually been distributed to projects benefiting local indigenous communities. A World Bank study found the fund has been "heavily influenced by local politics" and used for urban infrastructure and agricultural settlers (Babelon and Dahan 2003).

well-documented 'downside'; this, plus the factors above, has meant concerted opposition to oil exploration has been strong and supported by wider public opinion.

The veto players in the sector have both drawn on and contributed to this ideational context. The popular resonance of nationalist, anti-oil company ideology has continually made it a good political strategy to attack foreign oil companies, and one often used by environmentalists, unions and indigenous groups opposed to oil exploration in Ecuador's Amazon. Several of the veto players resemble those in the electricity and telecommunications industries: unions, and their representatives in Congress, businesses that benefit from contracts with Petroecuador, and their representatives in Congress, political parties who need a source of power, contracts and jobs for party members and families. Like the electricity and telecommunications unions, Petroecuador is one of the last remaining union strongholds. For years, it has invested in wages rather than infrastructure. There are numerous stories of inefficiencies within Petroecuador, such as a vast surplus of oil engineers and former employees hired as consultants.[205] Job security and benefits are high.[206] Retirement pensions are generous and medical insurance is excellent. Through their links with Congress, and working directly with the executive, Petroecuador unions have repeatedly blocked reform attempts.[207]

Additionally, because oil production is concentrated in the Amazon, the indigenous communities who live there have been important veto players.[208] As Bosco Najamdey, President of the Shuar Federation, said: "The Shuar and Achuar peoples of the Ecuadorian Amazon want it to be known that the position of our

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Additionally, although many of the oil companies voluntarily conduct development projects in and around their fields in addition to their compulsory contributions, in the southern areas in which the oil companies are not operating, the communities are often unaware of this. Interview, Herb Vickers, General Manager, Burlington Resources Ecuador Limited (petroleum extraction company), 13 April 2005, 11am, Quito.

[205] Energy officials, former Ministers and politicians claimed repeatedly in interviews that surplus labour in the electricity, telecommunications and oil sectors was extremely high.

[206] In interviews, current and former oil sector policy makers listed the union privileges they felt most egregious: a $1000 allowance for ophthalmology and $500 for otolaryngology given to all workers regardless of their health status, ten annual 'heroes of Petroecuador' who are given a holiday to Europe. Dismissal, which is difficult, can carry a 'golden handshake' of up to two or three years' salary. There are myriad bonuses, such as a travel allowance granted automatically with no requirement that travel actually be taken. Former President Durán Ballén claimed that when he was President (1992-96) his salary was about half that of a Petroecuador messenger boy. (Interview, Sixto Durán Ballén, President of Ecuador 1992-96, Quito, 12 April 2005, 4pm).

[207] They were directly responsible for some of the legislative obstacles described above. A particularly clear example was in early 2004, when the oil reform which would have legalised joint ventures between private firms and Petroecuador in state oilfields failed due to union opposition.

[208] Amazon Watch (2005a). See also Gorman (2002).

communities is 'no' to oil exploration, 'no' to dialogue and negotiation, 'no' to deforestation, 'no' to contamination, and 'no' to all oil activities." The case of Burlington Resources Ltd, an American oil company, demonstrates their power. In 1999, Burlington acquired subterranean rights to 'Block 24', 200,000 hectares of rainforest in the south-eastern Ecuadorian Amazon. Since then Burlington's operations have been paralysed by opposition from a coalition of indigenous organisations and environmentalists. After eight years, Burlington had spent $10.5 million on its two blocks but achieved no significant progress.[209] CGC, an Argentine oil company, faced similar issues in adjacent Block 23. A case brought by the indigenous group in the area, the Sarayaku, is before the Inter-American Commission and Court on Human Rights of the Organization of American States.[210] Indigenous concerns were taken up at legislative level by Pachakutik, which in February 2003 issued an ultimatum demanding that oil drilling in the Amazon cease. Later that year, the Ecuadorian government recognised local opposition by declaring *force majeure* in Blocks 23 and 24. Then, in May 2005, the Attorney-General indicated 'anomalies' regarding the protection of human rights had been found in the contract between CGC and Petroecuador, and that this could lead to unilateral termination of the contract, as well as compensation to the state from CGC.[211]

In oil, as in the electricity and telecommunications sectors, other businesses survive because of inefficiencies, and oppose reform. [212] Additionally, poor administration facilitates pure theft. For example, there are no automatic instruments to measure the flow of oil through the pipeline from the east to Esmeraldas; oil can easily be stolen.[213] The benefits of this corruption flow throughout the system: from workers of businesses that profit, to the business managers and politicians who receive bribes. Presidents can name friends and family to influential positions and from there extract funds, lucrative contracts and other concessions. For example, those who set the oil price are easily able to offer heavily discounted rates for oil to

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[209] Burlington tried to persuade the indigenous groups in the region to allow exploration, principally through packages of finance and gifts, but failed to change their preferences. Interview, Herb Vickers, General Manager, Burlington Resources Ecuador Limited (petroleum extraction company), 13 April 2005, 11am, Quito.

[210] Other indigenous federations have also filed injunctions against oil companies on the grounds of collective rights violations (Amazon Watch 2005a).

[211] Amazon Watch (2005b).

[212] For example, gas is taken south from Esmeraldas to Guayaquil by ship. It is said that those who profit from this therefore oppose construction of a longer pipeline, which would be cheaper.

[213] Interview, former Minister, Quito 2005.

contractors in exchange for kickbacks. This is a disincentive for a president to reform Petroecuador's structure or to bring it under more independent scrutiny. As with the utility privatisations, the role of the state in this is central, and privatisation would curtail vested interests' rent-seeking opportunities. (For their part, those opposed to private participation in the oil sector point to private sector corruption.[214])

In addition to this, executive incapacity stymied reform. While one part of the Ecuadorian government was trying to attract oil investment into the sector, another part was repelling it. A World Bank study found that foreign oil companies were put off by juridical insecurity, lack of clarity regarding indigenous rights and the obligation to consult, arbitrary and discriminatory tax authorities, and oil legislation which is "overly complex, confusing, lacking transparency... open to considerable discretion."[215] There is no better illustration of this than the case of Occidental.

In 2001, foreign oil companies in Ecuador were informed that they had to pay VAT, which came generally as a surprise. Some companies fought the ruling and in July 2004, Occidental, an American company, won an $75 million international arbitration award against the Ecuadorian government. At that time, Ecuador's Attorney-General (*Procurador*), José Maria Borja, announced that he would review all foreign oil company contracts, beginning with Occidental. A few weeks later, the Ecuadorian government announced that Occidental had violated Ecuadorian law 34 times. The most significant allegation is that Occidental transferred 40% of its interests in Block 15 to EnCana without prior authorisation of the Minister of Energy. The Attorney-General argued that Occidental's contract should be declared void and its assets given to Petroecuador (without compensation).[216] As a US Chamber of Commerce representative said in a US Congressional hearing, it is difficult to conclude anything else but that Occidental is facing retaliation for winning the VAT case.[217] These two events had a significant impact on the sector. The imposition of

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[214] Interviews: Henry Llanes, former General Secretary of Petroecuador Workers Union (1 April 2005, 5.30pm, Quito); former Ministers of Energy and a private sector representative (Quito 2005). Foreign oil companies must work within the system—some are said to do this exceptionally well, with many companies said to have build 'backhanders' into their budget and to have strategically employed security companies.

[215] Babelon and Dahan (2003).

[216] Occidental denied that the transfer to EnCana was completed as alleged by the Procurador and argued it "either paid fines or legally challenged the other alleged violations and that, in any event, the Procurador's demand to cancel the contract and give its assets to Petroecuador is disproportionate to the alleged offences and tantamount to GOE expropriation of its assets" (US House of Representatives 2004).

[217] US House of Representatives (2004).

VAT affected investment decisions but, especially with oil prices reaching $50-60 a barrel, it could be factored into overall production cost. More important was the perception that oil contracts were vulnerable to capricious renegotiation. As one oil executive put it, a certain amount of 'creeping expropriation' is expected when working in developing countries:

> "You have a contract but the host government will push the edges of the limit of the envelope. So you know you're going to suffer some amount of economic degradation. But generally you know that they're going to stay within the law and the confines of the contract— just interpreting every term to the state's benefit. The companies never win when you have these arguments.... But people accept it as part of the game."[218]

The VAT decision, seen as qualitatively different, appears to have strongly discouraged potential new investors and has caused grave concern for current investors.[219] Many in the industry see the imposition of VAT as a unilateral breach of contract.[220] The same executive continued,

> "The VAT issue was the first one where people genuinely believed that the government had stepped over the line. They'd broken their own law and contracts. It really changed the feeling. A lot of people shut down major investments at that time."

Furthermore, oil firms were scared by what they saw as revenge on Occidental for winning a case against the government. Former Ministers and those who had worked in the energy sector expressed the belief that even had Occidental broken Ecuadorian law, this did not justify annulment—confiscation of a billion-dollar enterprise for the sake of $75 million. Interviewees, and those testifying in the US Congressional hearing, felt Borja's actions reflected personal political

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[218] Interview, Quito 2005.
[219] There is a strong feeling in the sector that were they not already committed to Ecuador (and facing losses if they choose to sell at the current discounted prices), they would not now make a decision to invest. Interviews, oil industry managers and former Ministers of Energy, Quito 2005.
[220] Interview, Herb Vickers, General Manager, Burlington Resources Ecuador Limited, Quito, 13 April 2005, 11am: "They broke their own law! That puts a totally different spin on it. If they're not going to honour their own contracts, what do we have left?"

ambitions.[221] By playing to anti-oil and nationalist feeling, Borja, who has been outspoken in prioritising Ecuadorian sovereignty over economic and trade interests, did indeed capture leftwing support.[222] In 2004 a 'Tribute to Jose Maria Borja' was held by the acting mayor of Quito (Pachakutik), attended by representatives of almost every party, as well as the leaders of the major indigenous groups. The tribute was intended to demonstrate "support for the Attorney-General for the way he has acted in petroleum matters (Occidental's appeal against VAT payments)".[223]

Would-be investors have been scared off by these issues of juridical and policy stability. As well as the failure of the 2003-4 bidding round, several foreign oil companies are trying to leave or have left Ecuador.[224] One, EnCana, had major difficulty selling its operation due to the unresolved VAT issue and its involvement in the Occidental arbitrations.[225] In September 2004 EnCana's CEO announced that their Ecuadorean assets, on sale for $1.5 billion, suffered more political uncertainty than any of its other operations. He compared operating in Ecuador to being on a never-ending roller coaster, and said EnCana's focus would shift to North America.[226]

Discussion

The 'oil reforms' were a package of policies designed to increase private participation. Unlike some of the earlier cases where veto players opposed the reform as a whole, in this case each veto player vetoed one or a small number of policies. Players' preferences did not necessarily *conflict* (that is, there was a feasible winset among veto players, if not agenda setters) but they focussed their veto on different policies: indigenous groups opposed Amazon drilling, unions opposed debilitating Petroecuador, and so on. Veto players were numerous and their relationships complex. This section shows that some veto power arose from state-led development in the oil sector, with formal veto players built into the sector's structure within Petroecuador and in Congress. There were also newer societal veto players. In 2000, key veto

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[221] In the USHR hearing, the following exchange occurred: "Mr. BALLENGER. Why is Mr. Borja behaving this way? I understand he is running for President. Mr. SHAPIRO. Yes, he has suggested that, sir. You have answered your own question. The gentleman has aspirations for higher office" (US House of Representatives 2004).

[222] Borja suggested changing Ecuador's investment treaty with the US to facilitate expropriations (US House of Representatives 2004), saying it damaged national interests. According to a news report, he dismissed concerns this might obstruct trade agreement negotiations as "less important than defending Ecuador's sovereignty" (Alvaro 2004).

[223] *El Universo* (2004b).

[224] Major players BP, Arco, Conoco, and Amoco have all recently departed.

[225] If Occidental's contract were cancelled, EnCana would lose its 40% interest.

[226] Zhu (2004), Raha (2004), Park (2005).

players in the oil sector were the unions and social sectors, who used Congress and the Constitutional Tribunal to veto. In 2003, a variety of entrenched business interests undermined attempts to increase the sector's efficiency. Throughout, both the so-called 'left' and 'right' undermined the juridical and policy stability of the sector, scaring off potential entrants and ensuring the 2004/5 round failed. We saw several of these veto players in the electricity and telecommunications section, but this section also introduced two new veto players. Firstly, a political actor from within the executive, the Attorney-General, channelled nationalist sentiment against foreign capital. As in the utility privatisations, undermining policy and juridical stability issues a credible threat to potential investors. Secondly, the indigenous peoples of the Amazon have proven, as in some of the earlier cases in this chapter, to be powerful veto players in stopping expansion of Burlington and others. Their veto is both formal (through appeals to domestic and international law) and informal (through strikes and protests).[227] In the next chapter, we will consider limits on this ability to veto oil sector reform.

Conclusion

As Chapter Two showed, the reform agendas generated in both 2000 and 2003 were ambitious. This chapter has shown how *over*ambitious the plans were. Reforms failed for three reasons: executive incapacity, legislative opposition, and a proliferation of societal veto players. In each of the seven cases, vested interests which profit from the status quo were powerful enough to resist reform, and the executive lacked capacity to overcome their objections. In Chapter Five, I shall consider the system-level reasons why disparate vested interests can wield veto power in this way. Here, I revisit the tasks of this chapter.

The first task was to establish whether and which veto players blocked the major reforms: how many there were, where they were located in political space, what their preferences were and by what mechanisms they exercised their preferences by using their veto. Tsebelis predicted that the more veto players there were, the more likely policy stasis would be. This chapter has revealed a proliferation of veto players in a complex system: institutional and partisan, covert and overt, 'left' and 'right', organised on ethnic, regional, and class lines. Both outcome and positioning

[227] See definition in Chapter One.

preferences were important in veto players' preference formation and therefore in eventual reform failure. Repeatedly, positioning considerations underpinned opposition to reforms. In cases such as civil service and VAT reforms, veto players' preferences changed as they moved in and out of congressional coalitions. Sometimes positioning was the *only* explanation which seemed to explain opposition (for example, of 'business' parties to labour market liberalisation).

The size, shape and relative position of winsets is also important in explaining stasis. This chapter has shown that veto players' preferences often differ remarkably regarding a particular reform, and in some cases are incompatible—that is, for some reforms there is no feasible shared winset. In some cases the same reform was undermined by both the so-called 'left' and 'right', when both benefited from status quo inefficiencies (the oil reforms, for example). The means of veto were also varied and complex. We saw a variety of tools used to credibly threaten decision-makers: formal vetoes in the legislature and constitutional tribunal (and the threat thereof), strikes on essential services, the threat of overthrow through mass mobilisations, and the threat to withdraw legislative support for an administration. As well as these threats made to domestic policy-makers, in the case of electricity, telecommunications and oil reforms credible threats were also made to prospective investors—that they might lose their investment. That so many varied players can each have a veto is significant, and its underpinnings will also be explored further in Chapter Five.

The chapter also showed that the military has an ambiguous role. Especially under Gutiérrez, factions of the military both enforced reforms (LPG and oil protests, for example) and were veto players (in Petroecuador and in civil service reform, and possibly in LPG). But the military was only ultimately successful in vetoing reform, not in enforcing it. In the LPG case protestors were pacified by policy reversal rather than overcome by the military. In customs, military presence could not save the reform, even under a President who was a former military officer and campaigned on an anti-corruption platform. The ability of Ecuadorian veto players to veto reform but not to enforce it is a key finding and will be further discussed in Chapter Five.

The second task was to consider change over time. Did veto players always have a veto, and if not, on what was this contingent? This chapter has showed that veto power depended on the ability to make a credible threat and that this in turn depended on executive vulnerability. Sometimes when the executive lost support, this outweighed compliance with the IMF agreement altogether. Furthermore, we saw the

path dependence of a player's credibility—since indigenous protestors had brought down the government in 2000, their threat of veto was more credible later than that of civil service unions. In other words, veto players were created when their demonstrated potential to overthrow combined with a vulnerable context to produce a credible threat.

The ability of an executive to work in an unstable, vulnerable context is therefore a critical determinant of reform success. In contrast, executive *incapacity*, the other side of any story of societal and legislative veto power, was an isolable variable in most of the cases considered in this chapter. In VAT, Noboa was able to overcome a legislative veto by making a deal with the PRE; but Gutiérrez' political capital was diminished by unrelated (drugs) scandal and he was unable to pass earmarking reform. Similarly, his executive began customs reform enthusiastically but was outmanoeuvred by a clever two-prong strategy by its opponents. Gutiérrez' team also a misused a golden opportunity by excluding Pachakutik just when they could have helped enact LPG reform. Noboa, too, miscalculated by sacrificing easy telecommunications for difficult electricity reform, then achieving neither. Finally, the divisions within the executive and Gutiérrez' inability to prevent the Attorney-General threatening oil companies with cancelled contracts meant potential partners in IMF-based oil initiatives were scared off.

In this chapter we saw that the agenda matched poorly with the capacity of institutions to implement reforms. The MEF dominates the agenda-setting process but lacks implementation capacity. Meanwhile, institutions excluded from the agenda-setting process were expected to help with implementation, notably Conam, the Solidarity Fund and the Ministry of Energy. The decline of the institutions which used to take major roles in negotiating IMF agreements seems to have made it easier to reach agreement with the IMF, but undermined implementation. In the next chapter, we shall see that the only major IMF-backed reform to have passed through Congress under either Noboa or Gutiérrez was a piece of legislation which consciously included multiple stakeholders in its design from the beginning and which was able to be implemented by the MEF.

The third task was to account for the failure of reforms which did not need to be passed by the legislature. As we saw, Pacifictel remained corrupt and unprofitable while its twin Andinatel became efficient and profitable even with a smaller market. A first and major step in reforming Pacifictel would have been replacing known rent-

seekers on the Board of Directors by contracting private administration. Nothing needed to be passed by Congress. The same was true of electricity, customs, and, to an extent, oil. This chapter has shown how such reforms can be undermined. Firstly, reforms can be vetoed from within the executive itself. In the 2003 LPG case Pachakutik did this successfully; conversely, the example of Minister Yturralde and the 2000 VAT increase showed he was not a veto player. They can also be vetoed from outside the executive. Key to this is understanding that there is little real distinction between reforms that need to go through Congress and those that do not. This is because the executive is not working to pass one reform at a time, but is preoccupied by a constant struggle to remain in power (a state explored further in Chapter Five). There is constant interaction between the executive and the legislature, and the President needs to maintain congressional support even for reforms entirely resident in the executive mandate. This sometimes entails voluntarily undermining reforms that Congress cannot directly dismiss. This vulnerability is contingent: executives are most susceptible to a legislative veto in times of Congressional instability, especially when the President's personal survival is in question. In Chapter Five, we will examine why instability is so pervasive in Ecuador, and consider exceptions.

The fourth task was to consider the implications of the analysis for agenda setters. There are several. Firstly, if all reforms ultimately respond to the interests represented in Congress and their interaction with interests outside Congress, this has implications for the strategy an IMF team and their supporters might take to implement reforms. It demonstrates that avoiding formally passing reforms through Congress is not sufficient to avoid the veto power of Congress entirely. But it also demonstrates that the government could end up better off overall in terms of leverage if it can avoid Congress. If two reforms need to pass through Congress, Congress can simply refuse both of them. If one does not need to pass through Congress, Congress needs to offer the government something in return for the government voluntarily cancelling its planned reform. Then, one must consider what that 'something' offered by Congress might be. If the 'something' is a different reform, then this is a step forward in terms of implementing an IMF agreement. However, more often during the terms of Noboa and, especially, Gutiérrez, that 'something' was simply political survival.

A second implication is the need to appreciate the complexity of Ecuador's political landscape. Examining the political economy of the seven reforms has revealed a complex set of societal veto players and interactions with the legislature. The VAT increase was blocked by an institutional veto player, the Constitutional Tribunal, acting at the behest of social sector political parties. The customs, civil service and LPG reforms were vetoed by partisan players: corrupt business networks, unions, indigenous groups, and their respective Congressional representatives. The final section's examination of utility privatisations and oil sector reform revealed complex interactions between institutional and partisan veto players, and between reforms themselves. The interactions between veto players and reforms show the necessity of being highly familiar with Ecuador's political terrain in order to formulate a reform agenda. Some of the veto players considered in this chapter were hidden, their rhetoric intended to disguise a vested interest. The contribution of positioning to preferences is also hard for agenda setters to predict. The outcome of the reform agenda was a product of complex interactions which even Ecuadorians well-versed in domestic politics would have been hard pressed to predict; this means the IMF has little hope of understanding the true impact of the policies it requests of the Ecuadorian executive. The customs reform passed, for example, bore little resemblance to the intended reform. Similarly, the civil service legislation was so successfully undermined by vested interests that at one point the MEF almost withdrew it altogether, as the outcome seemed likely to be worse than the inefficient status quo.

This is important because advocating a reform always involves an implicit cost-benefit analysis. There will always be transition costs, and, perhaps, costs involved with paying off losers. The more complex the reform terrain, the harder it is to make the cost-benefit analysis realistic. As an illustration of the dangers involved, consider the executive-legislative conflict demonstrated in this chapter. In order to comply with many of the IMF conditions, the executive must negotiate with Congress to pass legislation. In such negotiations, there are three main 'currencies' a government can 'pay' in: policy, appointments, and money. 'Policy' can be used in several ways, for example by eroding previous reforms, by compromising other items on the reform agenda, or by weakening other state institutions. Political appointments or dismissals are extensively used to garner congressional support—as one interviewee said, "all that's missing are the price tags". 'Money' refers to the several

instances in this thesis in which budgetary or off-budget spending to sectional governments was used to gain support of the corresponding parties or individual members. More than once a member of Congress has been seen—sometimes photographed—with large amounts of cash following an important vote. Each of these three 'currencies' undermines aspects of democracy, good governance, or depletes the central budget. This is not necessarily a reason to avoid reform, but it *is* a reason to ensure that the benefits of the reform outweigh these costs. Insisting on reforms without understanding the Ecuadorian political context may bring more costs than benefits.[228] As the cost-benefit analysis is complex, prioritising reforms requires a sophisticated and comprehensive knowledge of Ecuadorian politics and society.

This chapter has argued that three factors (executive incapacity, legislative opposition, and a proliferation of societal veto players) are individually sufficient causes of reform failure. I have argued that any one of these factors can undermine reform, although some of the reforms in this chapter have suffered more than one simultaneously. If this is true, a successful reform could only occur in the absence of all three factors. The best way to test this is to examine successful reforms in Ecuador. The next chapter does so.

[228] This is true even if one agrees with the IMF reforms per se.

Chapter Four: Evaluating Reform 'Success Stories'

Reforms do occur from time to time in Ecuador. Chapter Three begged the question: with so many veto players, how could anything ever be reformed? An explanation of reform failure in Ecuador must account for its rare reform successes. Chapter Three argued that reform was blocked by any of three factors: executive incapacity, legislative opposition, and societal veto players. It follows that reform is only possible in the absence of all three factors. The first task of this chapter will be to test this. It will be evidence in contrary if reform was able to occur in the context of any one of these factors.

If the first task is to consider how success was achieved, the second is to ask "... and was it really 'success'?" Chapter One said 'success' in reforms had three elements: *implementation*, *endurance*, and *achievement of stated aim*. Chapter Three focused on the first element, implementation, and this chapter examines the other two. Since Chapter Three's seven reforms were never implemented, they could yield no insight on endurance or achieving stated aim. This chapter considers reforms which were implemented successfully, and is therefore the first opportunity for us to consider *endurance* and *stated aim*. These two elements are open to interpretation, of course: we can never say a reform has successfully been 'sustained' since it might yet be reversed, and success on 'stated aims' can be hard to grade as reformers' aims may differ, may not be reflected by public statements, and may be partially achieved. This chapter will consider endurance until May 2005, the month after the period considered in this thesis, and will glean 'stated aims' from public statements by the reformers.

The four case studies of implemented reform were selected as follows. In interviews, policymakers and analysts were asked to name the most successful structural reforms in Ecuador over the past decade. Most found the question difficult, and some could not name any. Only four reforms were named in total by interviewees, and only one of these actually meets the criteria of being a structural reform within the last decade: the Fiscal Responsibility and Transparency Act (FRTA), which was the most common response. The other three answers given were the liberalisations of Sixto Durán Ballén (1992-1996), the tenure of Elsa de Mena at the Inland Revenue Service, and the construction of the heavy-crude oil pipe (known in English by its Spanish initials, OCP). Although two of these are not strictly structural reforms, and

the reforms of Durán Ballén fall outside the time period of this study, all three do stand out in recent Ecuadorian history as exceptions. The OCP is neither a 'reform' nor a reform package, but a public works project. However, it is useful to consider it since it is an exception to the inability to increase private participation in oil. The OCP was also linked to the failures to reform the oil sector since as much as possible had to be squeezed from existing fields. Neither the OCP nor the other three reforms considered in this chapter were implemented as part of an IMF programme. However, as we will see, the IMF did play a key role at times.

This chapter demonstrates that these implemented reforms did overcome the three factors identified in Chapter Three. However, I find this success was temporary and partial since each implemented reform either did not endure, or did not achieve its stated aim. Of the four reforms, two were reversed by 2005 and the other two remained but had not been able to achieve their stated aim (and did not look likely to do so). Moreover, the way one package of reforms failed—Durán Ballén's—made subsequent reform harder, even in unrelated areas. I consider these dynamics of reform failure in the conclusion.

The Fiscal Responsibility and Transparency Act

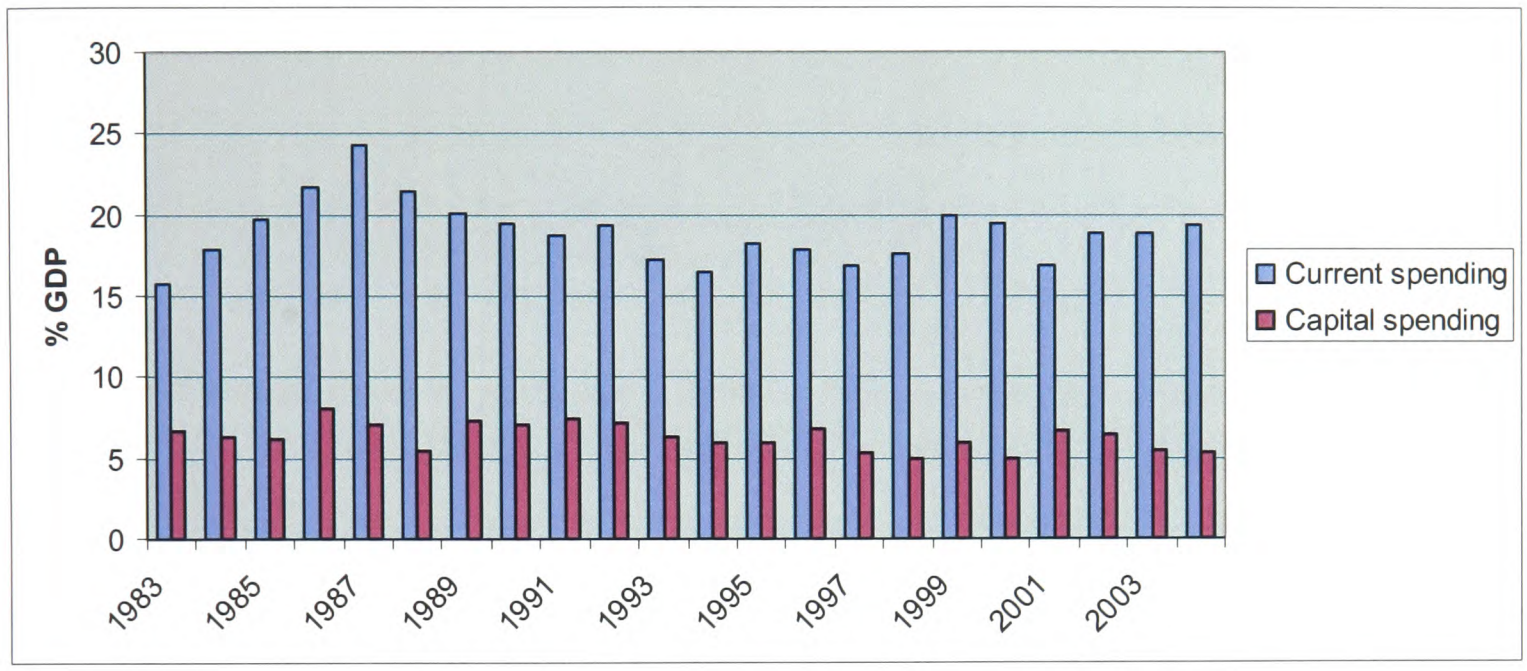
The FRTA was a package of fiscal sector reforms which passed on 4 June, 2002. The Act is generally seen by Ecuadorian economic officials as the key factor allowing healthy fiscal accounts in 2003 and beyond, and was a fundamental plank of the embryonic IMF standby. The original catalyst for the FRTA was two-fold: firstly, the reforms were seen as necessary to underpin dollarisation, and secondly, IMF mission chief Bob Traa was keen to ensure that the extra oil income expected from the OCP would be used wisely.[1] The law's main objectives were to establish a strict code of fiscal discipline; to neutralise the impact of oil price volatility through an oil stabilisation fund; to reduce public debt; and to increase transparency in the management of public funds. In the years before the legislation, Congressional largesse had increased expenditure, passing unfinanced spending laws in violation of the Constitution with impunity.[2] Figure 4.1 shows that by the 1990s, current and capital spending had stabilised at around 16-19% and 5-7% of GDP respectively.

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[1] Interview, Ramiro Galarza, Vice-Minister of Finance, 7 April 2005, 12pm, Quito.
[2] Araujo (1998) found that congressional intervention increased projected expenditure by 10%, and that 48% of bills from 1995-96 generated new expenditure.

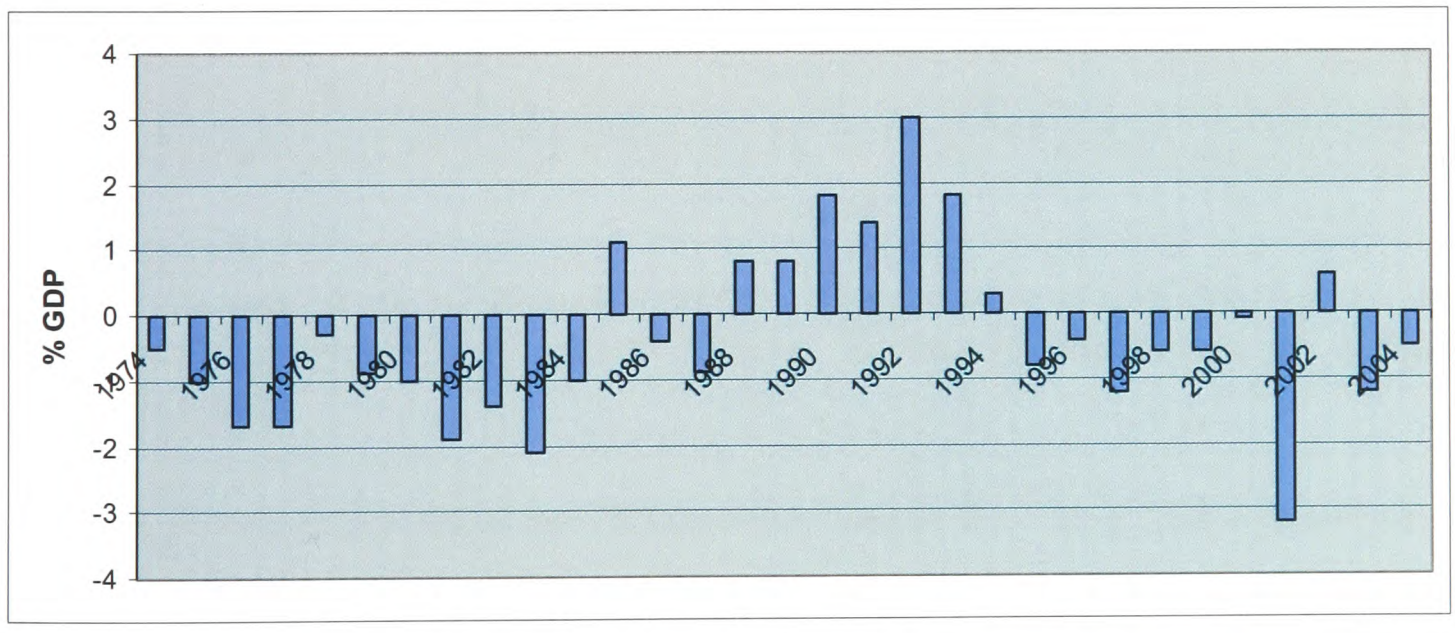
However, since GDP was growing, in real terms this meant large increases in government expenditure as Ecuador recovered from the crisis. As figure 4.2 shows, central government deficits had been a persistent feature for the last three decades, disappearing in the early 1990s then reappearing.

Figure 4.1: Government expenditure as percentage of GDP



Source: Central Bank of Ecuador (2005). 'Operaciones del Sector Publico No Financiero', www.bce.fin.ec.

Figure 4.2: Central government surplus/deficit as percentage of GDP

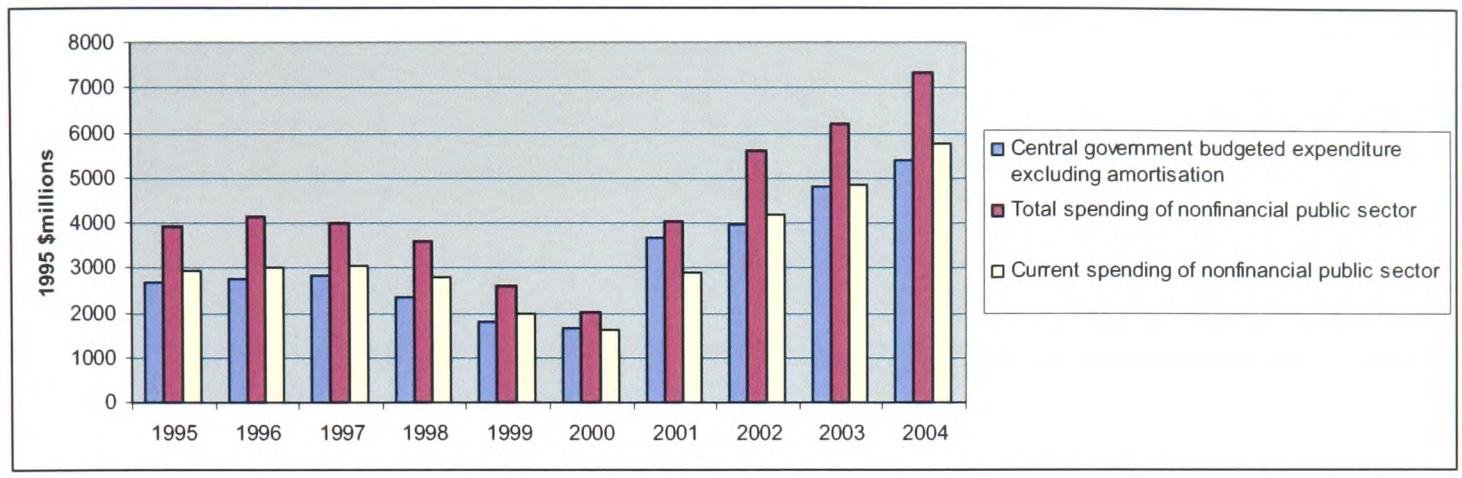


Source: ILDIS (2005). 'Economía Ecuatoriana en Cifras', www.ildis.org.ec.

One of the FTRA's key provisions aimed to restrict real increases in primary central government expenditure to 3.5% a year. As figure 4.3 shows, spending had decreased in the crisis years (1998-2000) then skyrocketed as Ecuador emerged from crisis. The FRTA aimed to return to the mid-1990s standard of less than 3.5% real

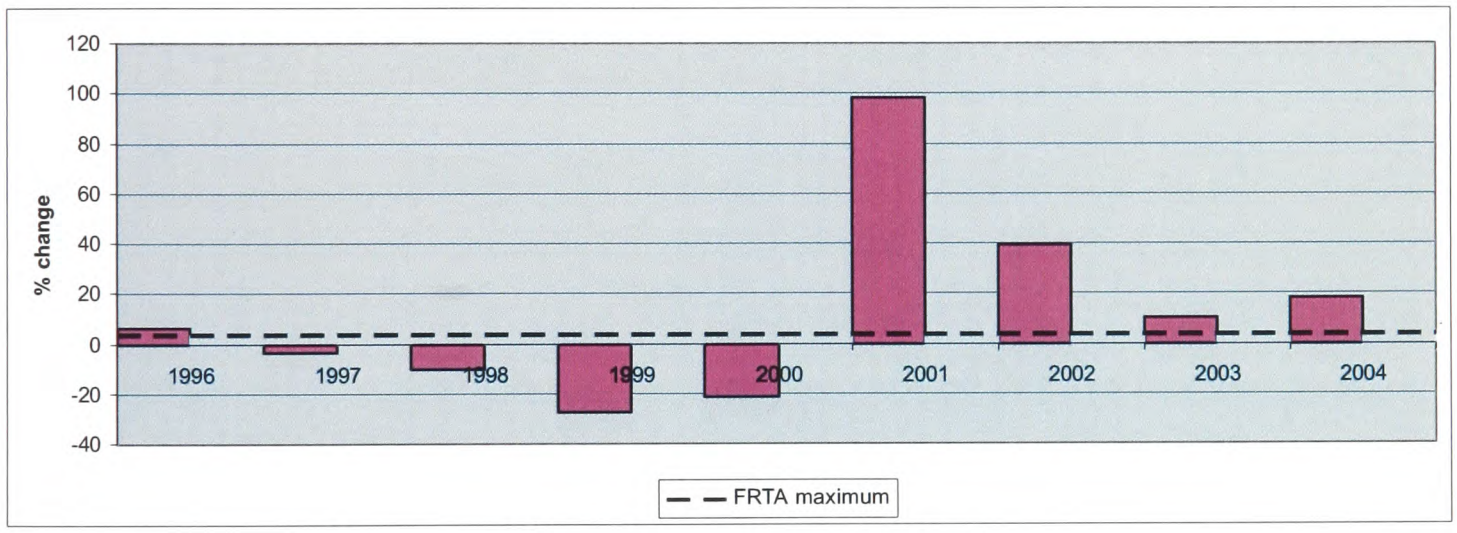
growth in primary central government expenditure, a maximum indicated by the line in figure 4.4.

Figure 4.3: Real expenditure by central government



Sources: Central Bank of Ecuador (2005). 'Operaciones del Sector Publico No Financiero', www.bce.fin.ec; ILDIS (2005). 'Economía Ecuatoriana en Cifras', www.ildis.org.ec.

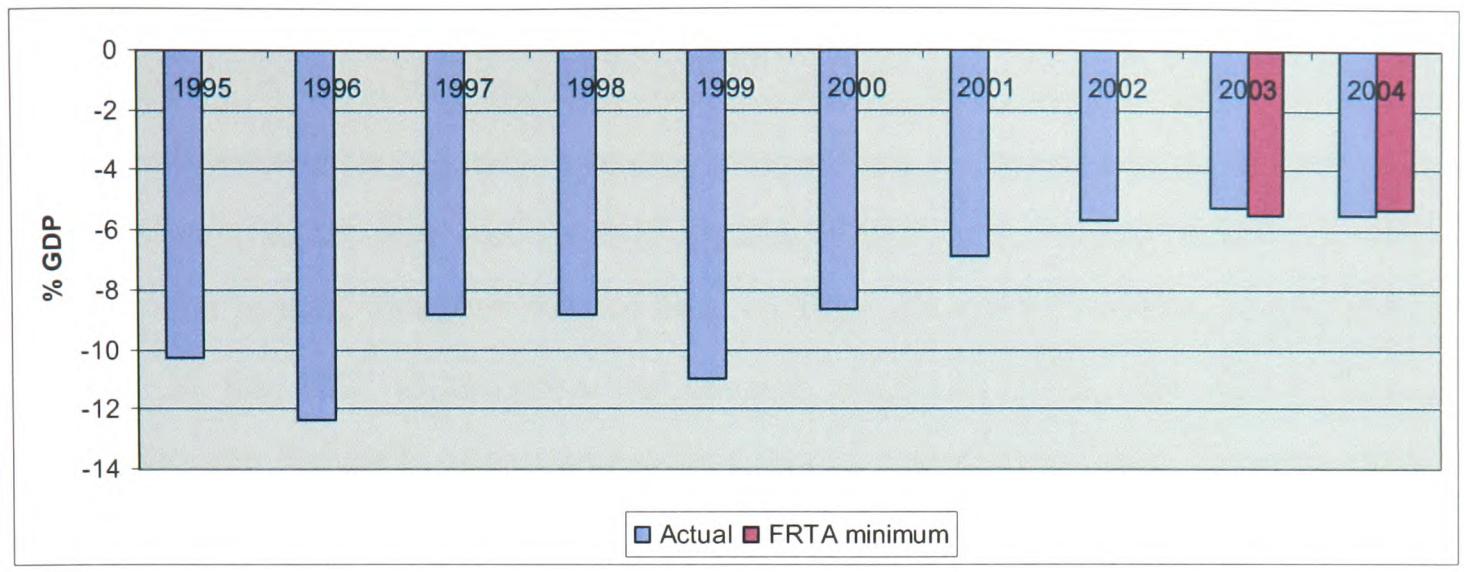
Figure 4.4: Year-on-year change in real primary government expenditure



Sources: Central Bank of Ecuador (2005). 'Operaciones del Sector Publico No Financiero', www.bce.fin.ec; ILDIS (2005). 'Economía Ecuatoriana en Cifras', www.ildis.org.ec.

A second provision of the FRTA was to reduce the non-oil fiscal deficit by at least 0.2% of GDP each year. From the crisis onwards, reductions had exceeded this target, but in earlier years the deficit had fluctuated (figure 4.5). The 'FRTA minimum' bars show the year-on-year reduction target (actually exceeded in 2003, just missed in 2004).

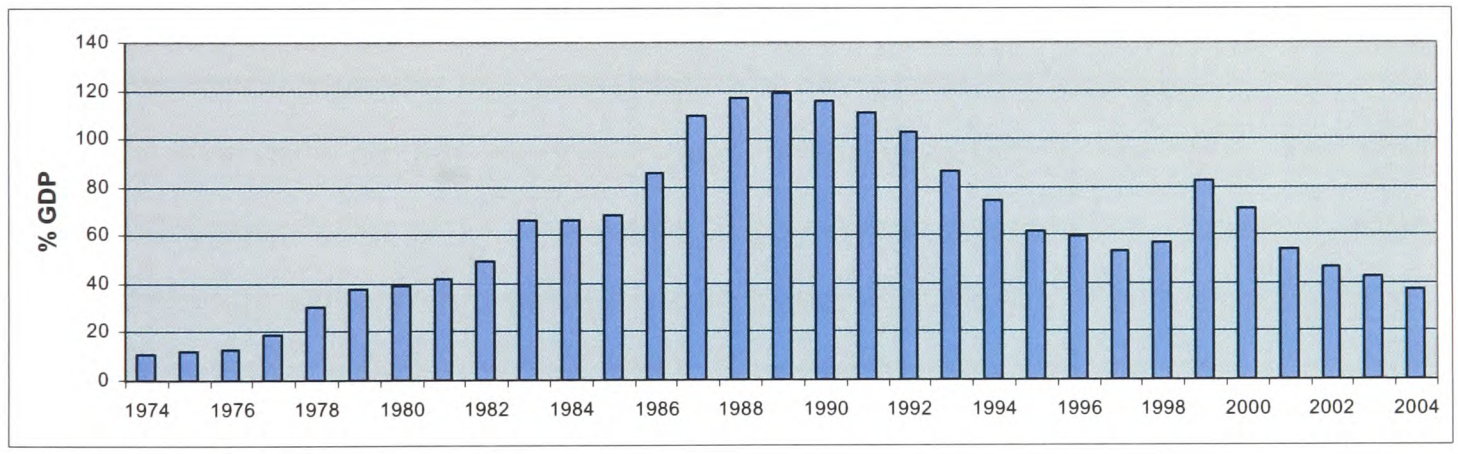
Figure 4.5: Non-oil fiscal deficit as percentage of GDP



Source: Central Bank of Ecuador (2005). 'Operaciones del Sector Publico No Financiero', www.bce.fin.ec.

The third major FRTA target was to reduce public debt to 40% over five years. The IMF's original intent was that this be *external* debt, which by 2001 had already begun falling from high levels during the crisis (figure 4.6).

Figure 4.6: Total external debt as percentage of GDP



Source: ILDIS (2005). 'Movimiento de la deuda externa', www.ildis.org.ec.

The FRTA provided that the government could pay back debt using 70% of the windfall oil income which would be held in the Social Investment and Public Debt Reduction Fund (Feirep). Of the remaining 30%, 20% was to return to an oil stabilisation fund and 10% was earmarked for social programmes. Although Ecuador is highly vulnerable to shocks, and had been devastated by natural disasters more than once in the past two decades, it had previously set up neither disaster insurance nor a stabilisation fund.

Executive capacity

The first necessity suggested by Chapter Three for successful reform implementation is executive capacity. In the case of the FRTA, a variety of actors contributed to executive capacity, working with willing elements within the MEF. The most significant factor was that the IMF tied the FRTA to a standby. Although when the FRTA was passed, Ecuador did not have an IMF agreement, similar proposals had been part of the IMF discussions for several years. In 2002, the FRTA was a precondition for the IMF agreement which never materialised (see Chapter Two). According to several interviewees, then Minister of Economy Carlos Julio Emanuel's top priority appeared to be securing the money that would come from an IMF agreement. Meanwhile, IMF mission chief Bob Traa had an unwavering commitment to the FRTA. The FRTA was to be the cornerstone of the standby, and the IMF spent a year negotiating its parameters. The IMF therefore had a key role behind the scenes convincing the government that the FRTA was worth spending political capital on, working with technocrats who agreed with them.[3] The US Treasury also strongly supported the FRTA, and—through the IMF and also directly with Ecuadorian authorities—advocated a strong version of the legislation prioritising buying back external debt over social spending.[4] Without these external influences, the government would probably not have fought for the reform in Congress.

Not everyone on the economic team was persuaded by the IMF. The IMF wanted 100% (not 70%) of OCP revenue to pay down external (not domestic) debt. Many technocrats agreed—but the economic leadership did not. When it emerged the IMF would refuse a standby in July 2002, Emanuel claimed that the 10% earmarked for health and education in the FRTA was the main sticking point.[5] This was inaccurate. The IMF did oppose the 'earmarking' on principle, but the real problem was the other 90%: the IMF predicted the 20% for 'emergencies' would be used for regular expenditure, and that the remaining 70% could be spent on internal debt, thus paying back no external debt at all. But Emanuel was in charge and the FRTA passed with this 10/20/70 split.[6]

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[3] Interviews, MEF and Central Bank officials, March and April 2005, Quito.
[4] Interviews, US Treasury officials, September 2005, Washington DC.
[5] *Agence France Presse* (2002).
[6] In May 2002, Noboa partially vetoed the bill and brought it back towards the provisions desired by the IMF by including specific percentages (10/20/70) rather than leaving it up to the president as the bill passed by Congress had. But Noboa's partial veto was not enough for the IMF, who wanted him to veto it altogether.

The split between the 'politicians' and the 'technocrats' within the economic team mirrored the split between those who wanted the IMF deal as a whole and those who did not (see Chapter Two). The 'technocrats' wanted to constrain spending; the 'politicians' within the ministry, such as Emanuel and Noboa, did not. Recognising this, the legislation was designed to commence well after those then in power were out. One reformer commented, "It was the only way these people were ever going to approve this law. And we did a good job explaining it to people. We let them know that it wouldn't affect them. They didn't worry about it too much."[7] The successful passage of the FRTA through the executive was partially due to this. According to insiders, as the FRTA was not going to affect President Noboa, he showed little interest in the legislation and was uninvolved with the political management of it.[8] The law was 'sold' in a variety of ways. Some within the executive seemed to respond to the opportunity to look like 'statesmen'—among other things, being invited to Washington.

As well as increasing political will, the IMF also contributed to executive capacity, working directly with MEF and Central Bank technocrats to design the FRTA. Crucially, the FRTA was one reform where the MEF could design and execute the entire thing itself. It was a reform whose effect would be felt widely, but the MEF would take primary responsibility for implementation rather than having to rely on other institutions of the state. This meant that—unlike some of the reforms in Chapter Three—the major bottleneck was Congress.

Legislative and societal opposition

MEF and Central Bank technocrats are well used to sending bills to Congress which they consider technically unassailable, only to have them rejected for political reasons. When the FRTA was first sent Noboa had little support in Congress, as usual. Moreover, the FRTA explicitly intended to constrain Congress, by preventing Congress spending the windfall profits from high oil prices, and limiting spending growth. This was particularly difficult as the 2002 national elections approached, encouraging expansive promises and pre-election spending. For these reasons, when the FRTA was first considered, Congress showed great resistance and the bill became bogged down in procedural process. The Government withdrew the bill and resent it

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[7] Interview, Ramiro Galarza, Vice-Minister of Finance, 7 April 2005, 12pm, Quito.
[8] Interviews, MEF officials, March and April 2005, Quito.

as 'urgent', meaning Congress had only 30 days to vote on it before it entered force automatically. Finally, after a long debate, on 25 April 2002 Congress approved the FRTA, although it was amended to give the executive (i.e. the MEF) discretion over Feirep. In the IMF's eyes, this was almost as bad as not approving it at all, but MEF technocrats felt the Act's passage was a major success against the odds.

Several factors helped the Act pass. Firstly, that it would come into force after Noboa's term may have helped avert some opposition from Congress just as it did from the executive. Secondly, it was presented as an intrinsic part of the dollarisation model. In contrast, the structural reforms of Chapter Three were largely seen as 'optional'—Ecuador had postponed them so many times that they were seen as less urgent. Thirdly, the law was politically managed before reaching Congress, through a wide consultation process. A typical legislative model would have a Ministry developing a piece of legislation and the President sending it to Congress for consideration. Atypically, the FTRA was developed by a small multi-institutional group which resolved its conflicts internally, before the group was gradually enlarged and more input was sought into the design of the law. The original group comprised the MEF and Conam, with support from the IDB, and the enlarged group included the Presidency, and then interested parties like the universities. Technocrats devoted time to persuading the chambers of commerce that the FRTA was crucial to support dollarisation, building up civil society support to counterbalance the civil society opposition to it (for example, from Jubilee 2000).[9]

Most of Congress appears not to have understood the legislation. Despite the educative consultation process, societal opposition seems not to have been communicated to parties effectively. Time and again, interviewees heavily involved in designing the FRTA said that "people in Congress didn't understand this law", that "they didn't notice it", "they didn't know what they were doing", "they definitely didn't understand what was going on", "I think they didn't quite understand the reality of the law."[10] According to one member of Congress from that period—an economist who agreed with the reform—even the party leaders' economic advisors could not understand the legislation.[11] The legislation was approved after what an observer

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[9] Interviews, MEF and Central Bank officials, March and April 2005, Quito.
[10] Interviews, IMF, MEF and Central Bank officials, Quito and Washington, 2005.
[11] "There were too many percentages, too many growth rates, too many deflators, too many complicated economic words. Maybe that was the strength that let the law be approved". Interview, Vicente Albornoz, 28 March 2005, 8.30am, Quito.

described as a "prolonged and confused" legislative session.[12] Noboa's (well-earned) reputation as an expansive spender may also have made the FRTA's constraints less threatening.

Other interviewees who helped to manage the reform argued Congress did not *need* to understand; that the real players were those you did not see. The IMF and MEF lobbied these groups to find those most amenable to the law. Some favoured it on principle. Others, who could rely on exemptions being passed to favour them, tended to support the law as they would be relatively better off. The IMF team, opposed to such exemptions, found it was a full-time job keeping track of parallel legislation passed by Congress, especially when beneficiaries of the exemptions did not wish to be discovered. IMF and MEF technocrats relied heavily on personal and political contacts to inform them of tax breaks, exemptions and undermining provisions in the implementing regulations, as well as the crucial legal difference between the 'organic' and 'inorganic' sections of the legislation[13] as provisions were moved during Congressional debate and as a result of Noboa's partial vetoes.[14]

We can now see how the FRTA was implemented. The IMF made it the centrepiece of a nascent standby, compelling the 'politicians' within the executive to support it. Then, the IMF helped the Ecuadorian technocrats promote the FRTA within the executive, and its design took account of the political concerns of the President, cabinet and other actors. The FRTA was able to be passed under Noboa because of shrewd political management, because Congress appears not to have grasped its significance, because it would come into force after Congress and the executive had gone; and, perhaps, because Noboa was a known spender. Then, crucially, the FRTA was able to be implemented because it could be executed entirely by MEF technocrats.

What about the FRTA's endurance and ability to achieve its stated aims? The FRTA lasted for the entire Gutiérrez administration. But although it persisted in name, in practice it began to be undermined almost immediately it was passed. Firstly, the 3.5% constraint on annual growth has always been exceeded. Secondly, and more significantly, the practice of rent-capture through the expenditure side of the budget

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[12] *Oil Daily* (2002b).
[13] 'Organic' law has precedence under the constitution.
[14] Interviews, IMF officials, September 2005, Washington.

was merely replaced by rent-capture through the revenue side.[15] That is, since 2002 legislators have shown an increased propensity to give tax breaks to favoured industries, the foregone revenue thus never entering the budget. In Ecuador, tax exemptions have tended to increase income inequality.[16] Building on this regressive base, the net effect of the FRTA, to the IMF's chagrin, is that the budget has become even more distorted.[17] Thirdly, although the intent of the debt-purchasing provisions was to reduce foreign debt, in fact Yépez' decision to buy back debt from the social security system instead led to no significant reduction in global bonds (see Chapter Three) and instead financed current spending in 2004-2005. Finally, the FRTA was essentially abolished altogether in 2005 under the Palacio administration.

Elsa de Mena's tenure at the Inland Revenue Service

In the late 1990s, the notoriously corrupt and inefficient *Dirección de Rentas* (Office of Taxation) was transformed into the efficient and effective *Servicio de Rentas Internas* (Inland Revenue Service, IRS). The old tax agency had been captured by corrupt bureaucrats and lacked an accounting system, a workable information system, or even up-to-date tax return forms.[18] Evasion was rife, reportedly 50-60% of liabilities.[19] In recognition of these problems, the IRS was created in December 1997 as an autonomous institution with its own budget. The key figure in the transformation was Elsa de Mena, who presided over the IRS from 1998 until 2004 and was appointed by President Mahuad the month after he took office.

The IRS was launched without great fanfare—unlike most of the other attempted reforms in this thesis. Similarly, de Mena's appointment was made with little fanfare and unremarked upon in the national press. The first reports of her existence related to the technical implementation of a new financial transactions tax;

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[15] As one IMF official commented in an interview, "Emanuel put great pressure on us that he'd passed this law. And what the lobbyists, Congress, State Department didn't realise was at the same time the things they did made it all irrelevant. Like passing exemptions, privileges."

[16] The World Bank's Public Expenditure Review found that in 1999, 43% of exempted taxes on education, books, health, transportation, water and electricity favoured the richest 25% of the population, and only 14% favoured the poorest 25%, and concluded that two factors explained the distortion: "the proliferation of taxes, and the concentration of high-income taxpayers in a small but well organised group that is able to shift the tax burden to a large number of 'small' taxpayers" (Izquierdo, Melo et al. 2004: 53).

[17] Interviews, IMF officials, September 2005, Washington.

[18] Arteta and Hurtado (2005:178).

[19] *Latin America Weekly Report* (1998), Maldonado (1998).

there was nothing about plans to revolutionise the institution nor profiles of her past work. In contrast, tributes flowed when she left. *El Comercio,* Quito's major newspaper, ran headlines such as "Director of Inland Revenue leaves a successful administration",[20] and "Inland Revenue director's excellent management costs her the job",[21] and called de Mena "the best public functionary in at least the last 25 years" and "the most efficient tax collector in the history of Ecuador."[22] Another major newspaper *Diario Hoy* said de Mena's appointment was "the only wise move Mahuad made".[23]

De Mena's family is not part of the Ecuadorian elite, nor is de Mena closely linked to a strong political party or industry. Moreover, she served under unpopular and/or unelected Presidents. Despite this, under de Mena's administration, tax revenue increased by over six percentage points of GDP.[24] Within five years, tax revenue more than doubled, from $1.48 billion in 1998 to $2.97 billion in 2003, increasing by 21.3% on average from 2000 until 2004.[25] The number of large taxpayers grew 77% in 2000 alone, thanks largely to information provided by the financial transactions tax, as well as de Mena's introduction of a unique register of taxpayers.[26] The average time to register as a new taxpayer fell from several weeks to an average of five minutes and 20 seconds.[27]

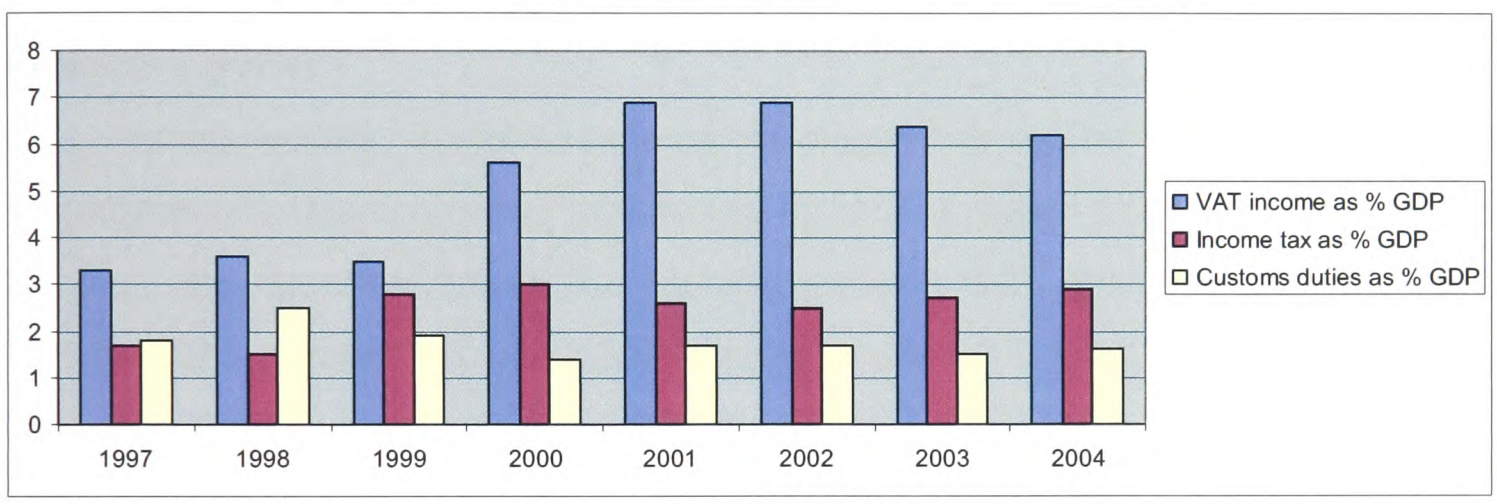
The impact of de Mena's administration is suggested by comparing areas under de Mena's control with similar areas not under her control, and with the same areas in a different time period. Figure 4.7 and table 4.1 do this. De Mena controlled the administration of VAT and income tax, but not customs revenues. Figure 4.7 shows a clear leap in VAT receipts—de Mena's top priority[28]—when her work began

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[20] *El Comercio* (2004b).
[21] Cevallos (2004)
[22] *El Comercio* (2004b).
[23] Marin (2004).
[24] Oleas (2004a:28).
[25] Mosquera (2005). An alternative explanation for Elsa de Mena's success is that, as described in Chapter Three, a combination of economic factors naturally increased tax take: high inflation on tradables, a relatively high incidence of taxes on tradables, a consumption boom and an increase in VAT from 10% to 12%. In 2003, of the total tax collection administered by the IRS, VAT was 60.5% (income tax was 26.1%) (*El Comercio* 2004f). However, the number of contributors also dramatically increased, almost doubling (up 95%) by 2004, to 329,913; and income tax collection increased in line with overall tax revenue—39% higher in 2004 (than 2003) alone (*Latin American Economy & Business* 2005). Clearly, although a good part of the increase was due to inflation, de Mena also had a large personal impact.
[26] *Spanish Newswire Services* (2000d).
[27] Drosdoff (2003).
[28] De Mena had begun with VAT and was just making inroads on income tax when she left office. Interview, Elsa de Mena, 8 April 2005, 9am, Quito.

to appear in the accounts, with income tax rising somewhat and customs revenue actually decreasing. Two years after de Mena took over, VAT increased and then stabilised at a high level—much more than the increase in its rate from 10% to 12% (in 2000). Table 4.1 shows average tax collection in terms of GDP in the seven years de Mena headed the tax administration, and in the seven years previous to her office: VAT increased the most (81%), income tax slightly less (71%), and customs only 15%. These data are consistent with de Mena significantly raising revenue in the areas she controlled, VAT and income tax.

Figure 4.7: Revenue sources as percentage of GDP



Source: Central Bank of Ecuador (2005). 'Operaciones del Sector Publico No Financiero', www.bce.fin.ec.

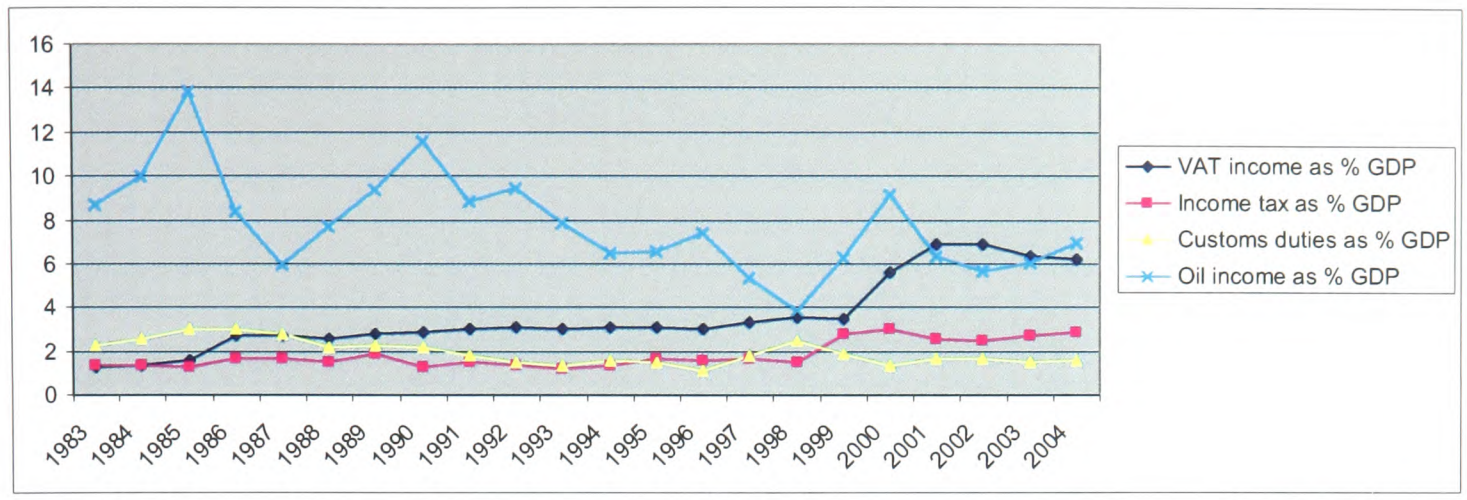
Table 4.1: Average IRS revenue before and after Elsa de Mena (% GDP)

	1991-97	1998-04	% increase
VAT	3.1	5.6	81%
Income	1.5	2.6	71%
Customs	1.5	1.8	15%

Source: Central Bank of Ecuador (2005). 'Operaciones del Sector Publico No Financiero', www.bce.fin.ec.

The longer view in figure 4.8 shows an historical step change in VAT income, as well as a large but less dramatic increase in income tax revenue, and the lower customs duties. Oil income is included for comparison. Under de Mena, VAT income increased so much that from 2001-2003 it was more important than oil income, which had been the most important source of state revenue for over 20 years.

Figure 4.8: Selected sources of government revenue since 1983



Source: Central Bank of Ecuador (2005). 'Operaciones del Sector Publico No Financiero', www.bce.fin.ec.

Executive capacity

In this section, 'executive capacity' is analysed on two levels: de Mena's own administrative competence and the national executive support for her. With crisis looming, the executive made the IRS autonomous and appointed a competent manager. The efficient tax administration pitted societal support against legislative opposition. During the last months of Gutiérrez' term, legislative opposition became more significant to his late-term executive, and there was a shift in the interests of some important societal veto players allied with Congressional parties. This case will show how despite her successful record—*because of* her successful record—de Mena was dismissed and the IRS again politicised.

Let us begin by considering why Mahuad appointed de Mena. It is striking that a politically-neutral bureaucrat was ever appointed to a role so central to economic and therefore political power. When Mahuad took office, Ecuador was basically bankrupt. Mahuad faced a fiscal deficit of 6% of GDP—$1.4 billion, of which only $1 billion could be financed—as well as 11% unemployment and 60% poverty.[29] The budget had been calculated with oil at $16, but just before Mahuad took office Ecuador's Pacific crude was under $7. El Nino storms and floods had made 20,000 people homeless, damaged over 2,000 kilometres of roads, and devastated coastal agriculture. Economic contraction and 40% inflation were forecast.[30] Mahuad himself recalled, "When I took office on 10 August, for every 1000 sucres we owed—a debt that wasn't mine—we had 30 sucres in the vault. Strikes everywhere, wage claims

[29] *Hoy* (1998), Maldonado (1998).
[30] *The Economist* (1998).

from the police and armed forces, wage and salary increases without a cent in the bank or a line item in the budget."[31]

Mahuad had to raise funds quickly, and he had few options. Chapter Two explained how he attempted to raise IMF funds throughout his term, and why this effort was unsuccessful. Another way could have been to fulfil a campaign promise to increase VAT.[32] But Congress had turned down Mahuad's predecessor Alarcón's attempts to raise VAT from 10 to 14%. For the same reasons of political instability explained in Chapter Two, attempting a vastly unpopular tax increase was increasingly unattractive. Ecuador's traditional income stream, oil, had been declining steadily throughout the decade, with low prices in the late 1990s only the most recent problem (see figure 4.8)—but as Chapter Three showed, oil sector reform is a politically explosive issue, and would have taken a long time to implement. Instead, Mahuad pursued a way to increase revenue without involving Congress or running up against powerful veto players.

On taking office, Mahuad announced his intention to fulfil a campaign promise to sharply reduce tax evasion.[33] The IRS was independent from the MEF and had financial and administrative autonomy, although the MEF retained control of fiscal policy and administered public spending. This autonomy underpinned de Mena's administrative changes.

De Mena quickly became the heart of the IRS; as newsmagazine *Vistazo* said, "She embodied the rise and fall of the IRS".[34] Throughout her tenure, de Mena was highly regarded in Ecuadorian and Washington institutions alike as a forceful, strong, honest and capable personality. She initiated several high-profile battles, including a prison order for powerful businessman Fernando Aspiazu for tax non-payment,[35] and, as we shall see, confronted foreign oil companies with a controversial taxation decision. As a former member of Congress said, "The Chairman, we call her the Iron Lady, like Thatcher. She's very efficient. No-one used to ever pay taxes, not for the last 100 years."[36] In keeping with her background in financial administration and in

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[31] *Hoy* (1998).
[32] *Latin America Weekly Report* (1998).
[33] *EIU Business Latin America* (1998), Maldonado (1998).
[34] López (2004).
[35] Muñoz (2005).
[36] Interview, Vicente Albornoz, CORDES think tank, 28 March 2005, 8.30am, Quito.

the public sector, de Mena explained her success in terms of good administration.[37] (Tanzi, writing in the political economy literature, agrees: Where tax bureaucrats have discretion, "tax administration *is* tax policy."[38])

De Mena worked to improve the credibility and comprehensiveness of tax data to enable the IRS to confront contributors. Previously, corporations had informed the tax administration at the end of each year how much tax they owed; there was no paperwork. When she began, administrative procedures were mostly manual and the tax database was stored on obsolete computers.[39] The old tax department comprised many regional offices, but no central taxpayers' registry, making it impossible to punish tax evaders.[40] According to de Mena, "People were accustomed to simply not paying taxes they owed and bargaining for a reduction with the tax authorities."[41] One of the first steps was to dismiss the vast majority of the old personnel, who de Mena saw as "corrupt", "unmotivated" and "lacking the personality for tax administration".[42] 1300 left, some resigning, leaving only seven of the originals.[43] In their place de Mena hired "an elite group, a first class team" and increased training. She set up basic systems of tax administration: a national register of unique contributors, a system of declarations, a billing system and an auditing system, incorporating cross-checks with VAT declarations for the first time.

IRS efforts focussed on VAT rather than income tax. As a flat tax, VAT had fewer 'big fish' whose criticisms of de Mena might influence the government. Income tax, however, was barely paid by Ecuador's richest and increasing its collection would have necessitated a series of major battles. One who worked closely with de Mena said that she had had the necessary information to begin collecting income tax, but delayed this most difficult task throughout her administration.[44]

A particular boon in the late 1990s was the 1% financial transactions tax mentioned in Chapter Two, the impact of which is clearly seen in figure 4.8. This tax

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[37] Interview, Elsa de Mena, 8 April 2005, 9am, Quito: "The most important thing in tax policy is administration....And for the administration to have citizens' respect you to have to create an institution with integrity, values, managed according to principles."
[38] Tanzi (2000:448).
[39] Interview, Elsa de Mena, 8 April 2005, 9am, Quito: "There practically wasn't any tax administration. The income was practically null. The people were unmotivated."
[40] See Fretes-Cibils, Giugale *et al.* (2003:45). This enabled delinquent taxpayers to register at another regional office and avoid punishment.
[41] Drosdoff (2003).
[42] Interview, Elsa de Mena, 8 April 2005, 9am, Quito.
[43] *El Comercio* (2004c).
[44] López (2004).

was reviled by economic technocrats, but provided de Mena's tax administration with invaluable information about large transactions, facilitating cross-checks. Perhaps for this reason, the party which initially promoted the financial transactions tax as a substitute for income tax (the PSC) found its affiliates suddenly liable for more tax than ever before, and approached the IMF team to argue for its abolition—using the same arguments that opponents of the tax had used when it was introduced.[45] Even after this source of information was eliminated, de Mena's registry continued to grow. In 2001 and 2002, over 100,000 unregistered persons were discovered in cross-checks using the new registry.[46] Armed with credible information, de Mena was able to collect taxes from people and institutions which had never paid it before. The cross-checks also kept the newly-appointed tax officials honest.

A major obstacle to efficient administration was the lack of public confidence that tax was being collected fairly. De Mena's personal reputation as principled and honest was an asset in changing the culture of tax evasion. Early on, de Mena concentrated on improving the credibility of the IRS by closing VAT-evading businesses for seven days, plastering them with IRS posters. A high-profile arrest and later conviction for tax fraud of one of Ecuador's most powerful bankers, Fernando Aspiazu, was intended to send a message that everyone would be treated equally, regardless of income. ("People understood that there was a new administration that meant business").[47] De Mena's introduction of a tax-paying culture to Ecuador for the first time was widely acknowledged as one of the most important, and difficult, of her achievements.

The legislative and societal veto players: how they tried, failed, and then succeeded

On 6 September 2004, following six successful years at the IRS, de Mena was abruptly dismissed by an executive order of President Gutiérrez. The next day, she was replaced by a founding member of Gutiérrez' PSP party, Vicente Saavedra.[48] We saw above how political and economic factors facilitated her nomination; this section will consider why she was maintained for so long—and what changed. By analysing how societal veto players and legislative opposition interacted to maintain and then

[45] Interviews, IMF officials, September 2005, Washington.
[46] Fretes-Cibils, Giugale *et al.* (2003:52).
[47] Drosdoff (2003).
[48] *Latinnews Daily* (2004).

undermine de Mena, we can understand her dismissal and the consequent erosion of the institutional reform.

An important factor in de Mena's maintenance was support from the multilateral institutions, who strongly approved of her efficient tax administration. De Mena was seen positively by many of the key players in Washington, including those who knew her only by reputation but hoped she would remain in office. There was general recognition in Washington—at the multilateral and interested American institutions alike—that the transformation of the IRS was due to de Mena's 'force of personality', and that her continued leadership was key to maintaining its quality.[49] At times during de Mena's tenure, IMF mission chiefs worked closely with her, sharing information and frequently reminding the President that a good tax administration would fund his other programmes.[50] Although there was no specific condition in a Letter of Intent mandating de Mena's continued employment, the informal support of the IMF was seen by others as instrumental in delaying her dismissal by the President.[51] Moreover, the 2003 agreement did contain a condition that customs administration be brought under the IRS (see Chapter Three). This was the closest the IMF could come to allocating responsibility to a specific individual. The others helped, too: de Mena was 'morally', but not financially, supported by the World Bank,[52] and the new IRS received $15.8 million from the IDB for technology, human resources and administration.[53] Moreover, this support was public. In 2002, IMF mission chief Bob Traa was reported in Ecuadorian newspaper *Hoy* expressing approval of progress at the IRS, and strongly implying that continued performance would help an IMF deal.[54] A month later, following an IMF visit, newspapers reiterated that the IMF looked favourably on the management of the IRS.[55]

This pressure worked upon the President. As we have seen, IMF exhortations are not generally sufficient to achieve a given reform. But in most cases, this could be

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[49] Interviews, US Treasury, State Department and IMF officials, September 2005, Washington DC.
[50] Interviews, IMF officials, September 2005, Washington DC.
[51] Perhaps surprisingly, Elsa de Mena herself attached much less importance to the support of the IMF and World Bank than did others who were politically active at that time. Interview, Elsa de Mena, 8 April 2005, 9am, Quito.
[52] Interviews, World Bank officials, March and April 2005, Quito.
[53] Drosdoff (2003). However, De Mena downplayed the extent of support—both financial and moral—she received from other IFIs. In particular, the IMF's advice was rejected as being inappropriate for the Ecuadorian political context. As de Mena said: "[The IMF] wanted me to begin by establishing a department for large contributors. And this did not seem like a good strategy to me…So I ignored him. And this person said that this institution is destined to failure."
[54] *Hoy* (2002e).
[55] *Hoy* (2002b).

blamed on a veto player, especially Congress. In contrast, maintaining de Mena depended *solely* on the President. Accountability was clear. The media ensured the public also knew this, in numerous portrayals of de Mena as a courageous, tough (but vulnerable) lone wolf battling shadowy corrupt forces. When Gutiérrez took office, newspapers discussed de Mena's pending ratification days beforehand, revisiting her successes and explaining her goals.[56] As *Diario Expreso* spelled it out: "removing the lady of the IRS would have been seen as surrendering to powerful circles of economic and political influence."[57]

However, executive support was passive. De Mena never perceived strong support from either the Mahuad, Noboa or Gutiérrez administrations, despite her contribution to financing their budget.[58] Aside from the multilateral donors, De Mena felt her biggest asset was society's recognition of her work.[59] She commented:

> "There were phenomenal interests involved.... But the straw that broke the camel's back was the television broadcasts with videos of flagrant bribes from illegitimate businesses that happened every day in the Dirección de Rentas. This sunk in, and no-one in society could oppose the reform."[60]

Then the balance of power changed. On 30 April 2002, de Mena announced that foreign private oil companies would *not* be exempt from VAT obligations.[61] Most had thought they were, and some sought legal remedies (see Chapter Two). The VAT issue persisted for over two years, and in fact was never resolved during de Mena's time in the IRS. One insider claimed that the American Embassy pressured the government to dismiss de Mena, on the grounds of her imposition of VAT on oil companies, particularly the largest American company in Ecuador, Occidental. It is definitely the case that the American Embassy worked with Occidental in its fight against de Mena's decision; even if the VAT issue did not cause the American embassy to actively oppose her administration, it seems reasonable that it would at

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[56] *El Comercio* (2003b).
[57] Mendieta (2004).
[58] Interview, Elsa de Mena, 8 April 2005, 9am, Quito.
[59] "Society defended me in every moment. They discovered an administration that didn't extort from them, with absolute political neutrality". Interview, Elsa de Mena, 8 April 2005, 9am, Quito.
[60] Oleas (2004a: 27).
[61] De Mena, and other government representatives, insist this was merely clarifying the rules. Others alleged de Mena was attacking oil companies because other easy pickings had dwindled (Interviews, Quito 2005). This was vehemently denied by de Mena: "It's not that I reached a maximum. There is still more growth to be had there. There was no worry about that – the big contributors had never paid, there was still a huge margin to work within." Interview, Elsa de Mena, 8 April 2005, 9am, Quito.

least diminish their support for her. Then in 2004 the IMF deal expired and all agreed there would not be another, so the IMF's support of Elsa de Mena lost some of its weight. In fact, de Mena was dismissed almost as soon as it became clear the IMF agreement would not be renewed. Of De Mena's two major supporters, then, one lost motivation and the other lost influence. With them out of the picture, it became much easier for actors within the Gutiérrez administration to begin arguing for her dismissal.

While de Mena's 'defenders' lost influence and motivation, her 'attackers' were gaining on both fronts. De Mena had always suffered personal attacks, including a lawsuit by a PRIAN member who alleged she had embezzled and concealed goods,[62] accusations that she was "fundamentalist" and did not appreciate the work of the private sector,[63] and calls for her removal, such as that by a member of Congress for Manabí after she characterised Manabí residents as tax evaders.[64] The cause of much opposition to de Mena is clear: businesses had been forced to increase their tax payments, many paying for the first time ever. As head of customs (a role she occupied *ex officio*), de Mena had instigated a policy of 'reasonable doubt' under which officials could open suspicious containers even if they had already passed two inspections. Importers opposed this policy to no avail when Gutiérrez had other support. By late 2004, however, Gutiérrez was increasingly politically desperate.[65] There were rumours of impeachment by the parties of the coast.[66] Gutiérrez' survival in the short term was uncertain, and depended on Congress rather than civil society. Pressure built within Gutiérrez' PSP, and other parties, to reassert control of the customs authority and to take full advantage of the IRS as a political tool to save Gutiérrez from Congress. Around this time De Mena received phone calls threatening her and her grandchildren.[67] In exchange for de Mena's dismissal, Gutiérrez won some short term congressional support for several projects from the PSC, Prian and PRE.[68] De Mena's dismissal was widely supported by the major coastal political parties with links to coastal business interests badly affected by de Mena's efficiency.

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[62] *El Comercio* (2004c).
[63] Marin (2004).
[64] Coello (2004).
[65] Gutiérrez' political desperation can be clearly seen in his later accommodation with the PRE party, following a trip to Panama in early September 2004 to meet its exiled leader Abdalá Bucaram. The deal Gutiérrez reached with the PRE involved his dismissal of the Supreme Court and permitting Bucaram to return. This deal, the worst-kept secret in Ecuador, was universally and correctly predicted to lead to Gutiérrez' downfall.
[66] *El Comercio* (2004a). An impeachment attempt took place in November 2004.
[67] Interview, Elsa de Mena, 8 April 2005, 9am, Quito.
[68] *El Comercio* (2004e).

This was obvious from the muted response in Congress to what was clearly a politically motivated act.[69] It also appeared that the decision was made independently of the economic team, as Minister of Economy Yépez returned suddenly from Washington on hearing of it.

After de Mena left the IRS was re-politicised in two ways. Firstly, the IRS lost political neutrality in the selection of personnel. When de Mena was dismissed from the IRS, many of those she had handpicked to work with her were also dismissed. De Mena said, speaking in April 2005, "Now only those from the PSP enter. In my time I had no idea of the politics of those I hired. They took the tests and if they passed, they entered." As entry standards dropped, the efficiency of the organisation began to be eroded.[70] Secondly, the tax machinery began to be deployed selectively against the opposition of the government, whoever that happened to be. One case was particularly high-profile: Under de Mena, the IRS had been about to impose a $12 million fine on PRIAN party leader Alvaro Noboa for failing to declare taxes correctly. But new IRS head Saavedra's appointment was a bargaining chip in a coalition negotiation with PRIAN; he was named an 'affiliate' of PRIAN[71] and reportedly linked to business interests of Alvaro Noboa.[72] After Saavedra was appointed, PRIAN and the PSP had an alliance in Congress and Noboa's multi-million dollar tax liabilities were suspended on appeal. Then, PRIAN refused to approve a judicial appointment, and the alliance broke. A week later, Noboa's tax liabilities were brought out of 'suspension'; the new tax authorities claimed that the timing was entirely co-incidental. The case was reported widely, eroding the neutral reputation of the IRS and sparking dire predictions. When de Mena left, newsmagazine *Vistazo* commented that many who gave their information to the IRS had done so because of the integrity of the institution's director, trusting that though they could lose money, the information would not be used against them politically. With de Mena gone, however, the data could have alternative uses by a weak government desperate to hold power.[73]

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[69] One source reported: "Following the announcement of the changes, Gutiérrez's political judgement was hardly called into question, and the second and third largest parties, the PRE and the Prian, defended the government. Even the Partido Social Cristiano, usually the government's fiercest critics, toned down their rhetoric for the day" (*Latinnews Daily* 2004).

[70] Interview, Elsa de Mena, 8 April 2005, 9am, Quito: "Right now, they have issued requests for information without realising that these declarations already exist in the system!"

[71] Joynes (2004).

[72] *El Comercio* (2004a).

[73] López (2004).

The lessons of this case are clear: crisis motivated reform by increasing technocratic autonomy, but was reversed when the pressure of crisis receded and short term political survival became the overriding consideration of the executive. Three key political conditions helped keep Elsa de Mena in office. Firstly, a desperation for revenue, and exhaustion of several alternatives to increasing tax revenue. Secondly, the support of the public, media and multilaterals, and a clear line of accountability to the president for maintaining her. Thirdly, a lack of opposition from key government supporters (at least while de Mena delayed pursuit of 'big fish'). The turning point came when the nature of support for the president changed. Supporting de Mena made sense for presidents who saw their survival as depending on multilateral and/or public opinion rather than on Congress alone. But ever since rumours of impeachment swelled in late 2004, Gutiérrez knew he could be removed at any stage by Congress. De Mena was replaced when elites' objections, reflected in Congress, began to carry disproportionate weight.

Drawing on a similar Peruvian tax case, Durand and Thorp (1998) call modernised segments of the Latin American state like the IRS, "islands of efficiency", with professional standards of admission and promotion and a stronger sense of the national interest.[74] In Ecuador, lack of reform elsewhere in the state constrained the reform and the 'island of efficiency' was swamped by hostile waters.

The construction of the OCP

The heavy-crude oil pipe (*Oleoducto de Crudos Pesados*, OCP) is a 300-mile, 450,000 barrel/day pipeline which links the Amazon oil fields to the port of Balao on Ecuador's Pacific coast. In June 2001, after a battle of almost ten years, the government signed a contract to build the pipe with OCP Ltd, a multinational consortium. The pipeline began operating in September 2003. Its route mostly parallels that of the Sistema Oleoducto Trans-Ecuatoriano (SOTE), previously Ecuador's only pipeline. The OCP doubled national oil carrying capacity, cost $1.3 billion, and was the biggest oil industry project in South America.[75] It was intended to

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[74] Durand and Thorp (1998:136). Many of the factors relevant to the Peruvian case also apply in the Ecuadorian: deep economic and political crisis, an autonomous agency, a newly recruited elite policy team, favourable public opinion, high level support (in the Peruvian case, from domestic politicians rather than multilaterals).

[75] EIA (2005).

generate up to $500 million annually,[76] and is a rare example of a successful political project during the time of Noboa.

It is worth reiterating that by 'successful' here I mean 'implemented'. There are many reasons to withhold approval of the construction of the OCP. Opponents mention permanent environmental damage, the devastation of villages and traditional ways of life along the OCP route, the creation of a highly unequal dual economy, severe human rights abuses during the construction of the pipe, and the doubtful economic contribution of the oil to the Ecuadorian economy, especially after known oil reserves run out in the coming decades.[77] Nevertheless, the OCP stands out as a government-initiated reform which came to fruition. Moreover, it was often mentioned by economic policymakers as a rare positive step over the past decade.

Executive capacity

The success of the OCP is often explained by observers as a result of "energy and persistence", an "extraordinary", "amazing" effort by Minister of Energy Pablo Terán, "a man of character".[78] Local newspaper *Hoy* called him "the minister who can do the impossible".[79] Those who worked with and know Terán attested to his intelligence, education, resolve, and ability to withstand personal and political pressure—including death threats and impeachment attempts[80]—with equanimity.[81] Terán also had the support of the President. This was crucial because although Terán was a charismatic and forceful personality within Noboa's cabinet,[82] several cabinet members opposed the OCP and repeatedly requested that Noboa remove Terán from his position.[83] On the other hand, external forces promoted the OCP to the executive. The oil companies kept strong pressure on the Ecuadorian government—allegedly even offering financial inducements to key members inside the government—to create

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[76] Farnam (2002).
[77] Opponents also alleged that most OCP investment would go towards imports and thus not benefit the Ecuadorian economy, that the state would not receive income from the OCP because its 20% royalty would be transported by the SOTE, and that estimated customs revenue was revised downwards several times and, three years later, was unknown.
[78] Interviews, Quito and Washington 2005.
[79] Hoy (2002c).
[80] The Spanish 'juicio politico', literally *political judgement*, is usually translated *impeachment*. Since 1998, Ministers cannot be forced out by Congress, so the process is more akin to censure.
[81] As one Member of Congress said, "Pablo Terán doesn't care what others think, doesn't care much about the law..." Interview, March 2005, Quito.
[82] As Chapter Two noted, he was able to convince Noboa not to raise fuel prices in a disagreement with "tough talking" "strongman" Minister of Economy Guzman over the IMF arrangement, causing Guzman to resign that day (Lapper and Moss 2000).
[83] Interviews, March and April 2005, Quito.

and maintain incentives to support the project. The OCP was also mentioned favourably in the 2000 Letter of Intent.

Terán's background allowed him to take these personal risks. Terán comes from a wealthy, prominent family and has foreign graduate degrees, one from Harvard; he does not need to live and die by the public sector. This matters because in Ecuador, an impeachment ruins a career civil servant. It demonstrates a lack of political support which will undermine future professional actions, and inspires politicians to invent public accusations to catch the media's attention as soon as it is clear an impeachment will succeed. Those accusations, however wild, cannot be refuted effectively. Terán's background and connections in the private sector allowed him to fear this consequence much less than others, and, in fact, he did take a role in the private sector after leaving the Ministry of Energy.

A key factor in the OCP's implementation was an early strategic decision by Terán to delegate Petroecuador's management to its President, Rodolfo Barniol. In contrast, other Ministers of Energy have been much more involved in running Petroecuador. Because the rewards in the oil sector can be substantial, many powerful groups are interested in Petroecuador, and conflict is frequent. By elevating Barniol, Terán was able to deflect these distractions. Terán gave Barniol a direct relationship to the President, which put him on an equal political footing; or even higher, as he had the power to award contracts. Barniol was a capable manager who lasted far longer in the role than is usual; 29 months, where the average from March 1997 until December 2004 was just seven months. His stable, competent management freed Terán to concentrate on the OCP.

Legislative opposition

Legislative opposition was less significant for the OCP than for other reforms. This was because the enabling legislation for the OCP was passed as a prior action for the 2000 standby which was negotiated with such haste (see Chapter Two). The legislation, *Ley Fundamental para la Transformación Económica del Ecuador* (Trole I) permitted the construction of a private OCP by private companies already exploring and extracting, without a public tender. Trole I passed by 'ministry of the law', that is, Congress did not consider it within the 30 day period required for declining legislation sent as 'urgent'. After this, there was no need for Congress to be involved with the OCP.

This does not preclude Congress blocking reform, as we saw in Chapter Two. But in the OCP case, the societal groups who opposed the OCP were not as tightly linked to congressional representation (compared to, say, customs). Crucially, executive commitment was high enough to overcome the threats that the legislature could make. There was some opposition to the OCP from Pachakutik, the ID and the PRE, and Terán suffered two attempted 'impeachments'. Both failed, but even had they passed, Terán could not have been removed without the President's approval, and Noboa had indicated he would ignore the result.[84]

Societal veto players

The OCP project was opposed by a range of actors. But even the most determined, like the environmentalists who blocked the route through the Mindo nature reserve for almost a year, could only delay its construction. Of the two main groups opposed to the OCP, one (environmentalists) was committed but lacked political power and the other (indigenous groups) had an ambiguous position.[85] Campaigns were fragmented and underfinanced. There were some shared forums—Acción Ecológica, for example, made joint declarations, press conferences and even lawsuits with the indigenous umbrella group Conaie—but not many shared resources.[86] Abroad, anti-OCP activists organised protests in several cities, particularly concentrating on the German financiers of the project, WestLB. But timing was against them. WestLB was attempting to develop its international loan offering and the OCP loan, one of its first, was important to its reputation.[87] Foreign environmentalists lacked political influence within Ecuador and their representations appear to have been largely dismissed by the executive.

Anti-OCP groups' initial success in gaining the sympathy of the media was superseded when the OCP proponents began a national PR campaign in newspapers and television, including statements by the President calling for national unity to facilitate the project. The campaign was funded by the oil companies involved in constructing the OCP, in conjunction with the Ministry of Energy. They aimed to

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[84] *Dow Jones Business News* (2002).
[85] While indigenous umbrella group Conaie issued press releases denouncing the OCP, and there were small protests, they never mobilised against at the national level as they had done against other policies (notably the removal of the LPG subsidy). See for example *Hoy* (2002a).
[86] Interviews, indigenous and environmental leaders, Ministry of Energy officials, 2003 and 2005, Quito.
[87] Maplecroft Ethical Insight (2005).

convince the public that it was impossible to transport heavy oil through the SOTE, that the OCP was therefore crucial to oil sector expansion, and that private capital was needed to pay for it. According to those working in the Ministry of Energy, the campaign was highly successful, with 80% of the population at one point supporting the OCP.[88] The campaign also targeted members of the media, making the case at breakfasts for reporters. As a result, members of Terán's team say, the media were convinced the OCP should be built.

One incident illustrates the strong forces behind the OCP. In June 2001 the Lake Agrio council rejected an OCP station to be located in their area, after local strikes against the project. Three months after their original decision, five of the seven councillors changed their vote in an extraordinary session amid rumours of $60,000-80,000 payments.[89] They then called for the resignation of the mayor of Lake Agrio, who remained staunchly opposed to the project. Meanwhile, OCP proponents told local businesses they would get more custom with the construction of the OCP, and these businesses pressured the municipalities. Pressure also came from the violence associated with rejecting the OCP proposal. Luis Bermeo, the provincial prefect and opposed to the OCP, suffered three attacks on his life around this time. Bermeo suggested the attacks were linked to his opposition to the OCP. Suspects testified that they had been hired for the attack by Eiliseo Azuero, a former member of Congress who allegedly owned over 200 vehicles used in the OCP construction.[90] Eventually, the mayor agreed to support the project in return for $12 million in public works.[91]

The state held other powerful cards: it could expropriate land and forcibly remove those who refused to leave, and arrest and deport activists.[92] Moreover, activist groups allege that the state abused its power.[93] A set of 149 interviews conducted by Acción Ecológica in 2002 along the OCP's route revealed that although consultation was constitutionally required, 67% had not been consulted, and none was consulted before the OCP Ltd. contract was signed. 23% had not signed a contract authorising OCP personnel on their property, and most of this group had suffered

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[88] Interviews, Ministry of Energy officials, April 2005, Quito. On the other hand, in the province of Sucumbíos, where the pipe was built, 80% of the population opposed the construction of Amazonas station (Weemaels 2002), and organisers of strikes against the OCP claimed 90% support (*Carbusters Magazine* 2002).
[89] Weemaels (2002), Jermyn (2003).
[90] *Periódico Panorama* (2003).
[91] Gall (2002).
[92] Farnam (2002). 14 activists were deported.
[93] Acción Ecológica (2003).

threats and destruction of chattels. 92% of those who signed contracts felt forced to do so.[94] At times, the state response was heavy-handed and violent.[95] Dedicated police officers were paid by the OCP consortium and attended the village meetings. As one activist alleged:

> "There would be a peasant meeting with 30 armed police surrounding them, "Right, let's negotiate. How much is your land worth?" And they would know about the deaths and torture in the next village... It was only possible to win via violence. These were people who would hit pregnant women."[96]

Moreover, activists complain that jobs, money and other benefits were promised to the indigenous groups of the area, but never materialised. 52,000 jobs were promised,[97] but it was later revealed there would be just 300 permanent maintenance jobs once the project ended.[98] One activist alleged that Ecuadorians were hired for a month, used for PR purposes, and then replaced by foreigners who would work for less than half.[99] In Acción Ecológica's survey, 87% of residents said OCP Ltd. had not done what it promised, and only one said the OCP brought net gains.[100]

The first three years of operation of the OCP coincided with the highest oil prices in three decades, a compelling incentive for the state and private sector to massively increase production. Instead, the private sector increased production much less than anticipated, and Petroecuador's production actually *decreased.* Originally the OCP was to carry an average of 450,000 barrels a day but two years later, shortly before the pipeline was completed, a revised prediction said the OCP would transport only 220,000, less than half of its capacity; and 75% of *that* would be redirected from the SOTE. In other words, the OCP was only allowing an increase of a few thousand barrels a day.[101] In response to one oil analyst calling this outcome 'a disaster', Terán continued to insist the OCP would attract large-scale investment and that Ecuador could produce a million barrels a day.[102] By September 2005, however, the OCP was

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[94] Weemaels (2002).
[95] Troops killed three protestors in March 2002.
[96] Interview, Jose Proaño, Acción Ecológica, 29 March 2005, 10am, Quito.
[97] Martin (2002).
[98] Forero (2002).
[99] Interview, Jose Proaño, Acción Ecológica, 29 March 2005, 10am, Quito.
[100] Weemaels (2002).
[101] Forero (2002).
[102] *Ibid.*

only transporting 165,000 per day.[103] Opponents now claim that OCP Ltd. and its supporters inflated their own quotas to help publicity, accepting they would pay fines for not meeting their quota later.[104]

This case demonstrates three things. Firstly, although many attribute the OCP's construction solely to Terán, it was due to a co-incidence of factors, including crisis as an auxiliary factor. It seems unlikely the project would have been established without a resolute individual like Terán, but he could only operate as he did with support from the public and, crucially, the President. Ecuador had just suffered its worst ever economic crisis, so it was easier to convince Ecuadorians that other people's sacrifices—of its environment, and of some indigenous communities' lifestyles—were necessary. The old attitude that 'oil companies are thieves' could be overcome by a huge PR campaign arguing the OCP was crucial to expand the oil economy. With public opinion on their side—that is, most societal opposition overcome—Terán and Noboa overcame objections within Cabinet and Congress. Then, with access to the state's powers of coercion, the rest of the societal opposition could be overruled.

Secondly, it is striking that indigenous groups could not veto the OCP but could veto the LPG reform (see Chapter Three). At no stage did indigenous groups rise up nationally against the OCP, perhaps because the OCP's impact was concentrated, while LPG reform's was dispersed. Conaie and other indigenous umbrella groups seemed to choose not to make the OCP a national issue. Furthermore, OCP Ltd's 'divide and conquer' strategy bought off individual indigenous leaders and groups, persuading them not to veto. The indigenous veto power is due to the mass opposition it can raise; this opposition was not mobilised against the OCP.

Finally, this case demonstrates this chapter's recurring theme: partial reform success without a supportive policy and institutional framework is reversed or undermined. It took massive amounts of the Noboa administration's political capital to establish the OCP; once it was built, however, the promised benefits never came because the sector more generally was unreformed. Because of the political problems in the oil sector discussed in Chapter Three, the OCP catalysed less investment than

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[103] According to the OCP Ltd. website, www.ocpecuador.com, on September 15 2005. *The Economist* reported in 2005 that few of the oil companies were meeting their 'ship or pay' requirements, under which they pay for a quota in advance whether they use it or not (EIU 2005b).

[104] Jose Proaño of Acción Ecológica: "They lied about how much they could get. They weren't just wrong; they knew, they lied....The only time the OCP has been full was the day it opened, when the President and the media was there." Interview, 29 March 2005, 10am, Quito.

anticipated, eventually merely attracting business from the SOTE. Implementation was achieved, the pipeline endures, but the reform did not achieve its stated aim.

Reforms under President Sixto Durán Ballén

The Durán Ballén administration (1992-96) is the most successful at implementing planned reforms since democratisation.[105] Under Durán Ballén, reforms were passed in fiscal and economic policy, especially relating to the Central Bank, important oil contracts were signed, and legislation was passed to privatise the oil, electricity and telephone sectors. Between 1993 and 1995, ten state enterprises were privatised (see table 4.2).

Table 4.2: Privatisations during 1993-1995 under Durán Ballén

	US $ million
La Cemento Nacional	53.8
Cementos Selva Alegre	40
Fertisa	0.9
Bolsa de Valores de Guayaquil	0.3
Bolsa de Valores de Quito	0.3
Parque Industrial Cuenca	0.2
Azucarera Tropical Americana	0.1
Hotel Colon	Under 0.1
Ecuatoriana de Aviación	33
Total	128.6

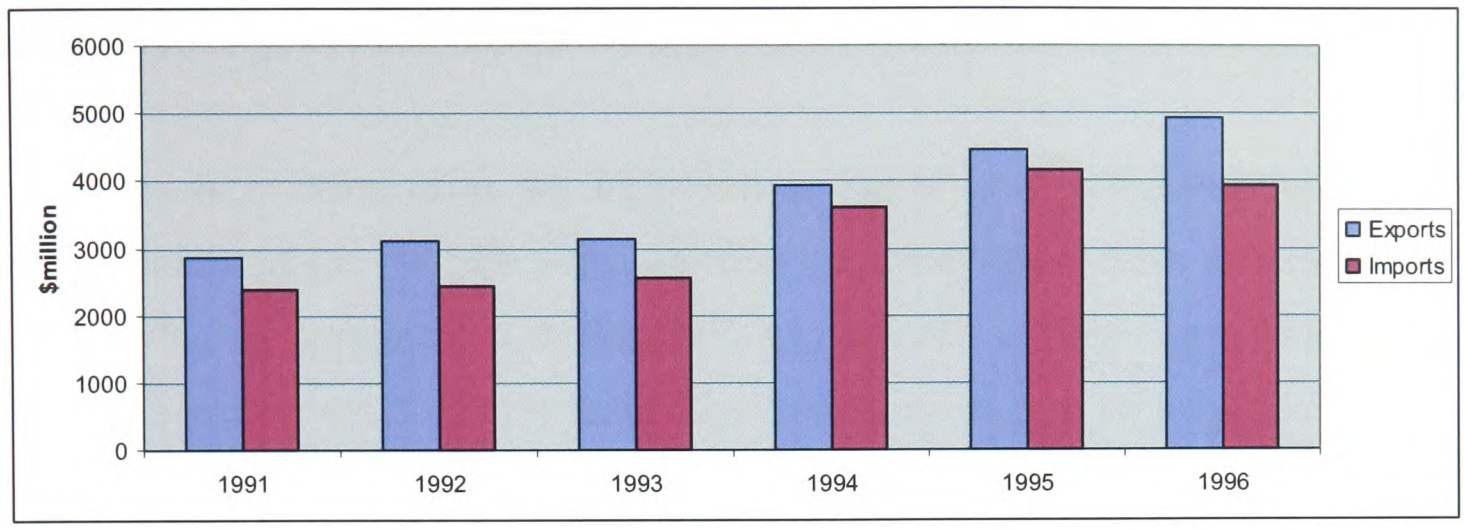
Source: Oleas (2004c: 68)

For the previous five years, Ecuador had had virtually no investment, low growth, the highest sustained inflation of its history, and a very weak external sector. After four years of the Durán Ballén administration, Ecuador had the highest foreign reserves in history,[106] exports were up 60% and imports 62% (see figure 4.9), the fiscal deficit had dropped from 7.1% of GDP to about 1%,[107] and inflation had fallen

[105] Durán Ballén was named the most 'reforming' president by a great majority of interviewees, even those opposed to his reforms. Former President Hurtado (1981-84) said that the four presidents after Durán Ballén "basically haven't made reforms". Interview, 14 April 2005, 5pm, Quito.
[106] *Chronicle of Latin American Economic Affairs* (1994).
[107] *Latin American Affairs* (1994).

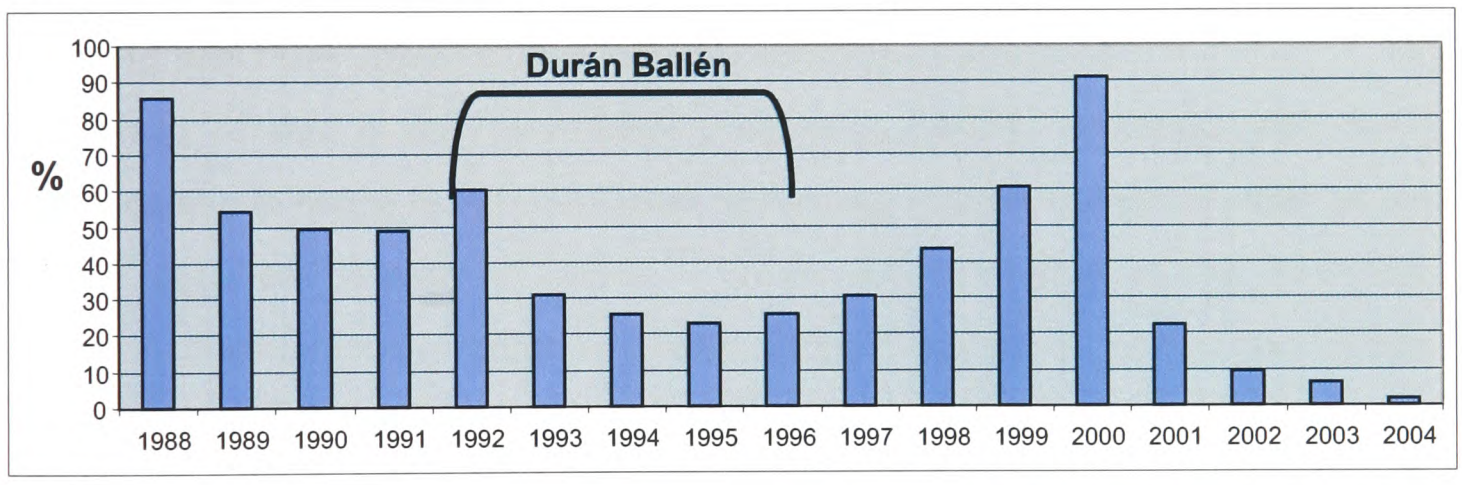
from 60% to 25% (see figure 4.10). The private sector began to respond and support the reforms, especially as growth increased rapidly in the final quarter of 1994.

Figure 4.9: Exports and imports under Sixto Durán Ballén (1992-1996)



Source: Oxford Latin American Economic History Database (2005), www.oxlad.qeh.ox.ac.uk.

Figure 4.10: Annual Inflation (end-December)



Source: ILDIS (2005), 'Economía Ecuatoriana en Cifras', www.ildis.org.ec.

Many of the reform processes initiated by Durán Ballén have never been completed by subsequent administrations, and recur in IMF agreements. It is therefore particularly appropriate to compare the reforms of Durán Ballén with others' attempts. This chapter considers Durán Ballén's reforms last because they reveal some dynamics of reform failure whose causes will be further explored in the next chapter.

Executive capacity

The 1990s in Latin America were a golden age of technocracy, to which Ecuador was a latecomer. A wave of reform was sweeping the continent. Economists had begun to share a view on which reforms could achieve sustained growth; a Latin

American consensus as much as a Washington consensus. There was optimism in Ecuador as Mexico took off despite its 'tequila crisis', Brazil stabilised its hyperinflation, Argentina looked to be growing sustainably, and the perennial Latin American curse of inflation seemed to be defeated. When Durán Ballén and his cabinet came to power this hope and faith in neoliberalism underpinned their reform agenda.[108]

Two facts demonstrate the high-level commitment to reform in the Durán Ballén administration: that the administration embarked upon these reforms even before having an agreement with the IMF, and that the reforms were undertaken during a time of great fiscal pressure. Economic indicators were very poor when Durán Ballén took office: inflation was over 60% (figure 4.10), external debt was over 100% of GDP (figure 4.6) and reserves were effectively zero.[109] During Durán Ballén's term, the average oil price was $13.54, once falling as low as $10—a major problem since the estimate in the budget was $17.[110] Durán Ballén also lacked Congressional support throughout his term. Despite all this, his administration managed to pass many more reforms than any subsequent president.

Much of this is due to executive capacity: quality, coherence and early, unwavering commitment to reform. Durán Ballén appointed a cabinet of experienced ministers regardless of party affiliation.[111] Of the fifteen original cabinet ministers, only four had affiliations to either of Durán Ballén's supporting parties, the Partido Conservador or the Partido Republicano. The other cabinet members were non-aligned or aligned against Durán Ballén, some belonging to others' parties—even the PSC, from which Durán Ballén had resigned in protest. One had campaigned for Jaime Nebot, the PSC's candidate against Durán Ballén. The cabinet is generally remembered as exceptionally high in quality. So too are the lower-level appointments, who tended to lack personal connections—rare in Ecuador—and who were given an unusual degree of autonomy.[112]

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[108] Krugman (1995).
[109] ILDIS (2005) figures show $782 million reserves in 1992, but Durán Ballén, who took office in August 1992, contested these figures: "The books show a surplus but that's because the accounts close in June and the foreign debt payment is due in July. I had zero." Interview, 4 April 2005, 4pm, Quito.
[110] US Energy Information Administration's West Texas International spot price, online at www.eia.doe.gov.
[111] Mejía-Acosta, Araujo *et al.* (2004) present evidence that on average 65% of Ecuadorian ministries are led by politicians with no explicit party affiliation; Durán Ballén pulled this average up, with 75%.
[112] Interviews, Quito and Washington 2005.

This high quality facilitated early adoption. The Durán Ballén administration, unusually, arrived with its economic programme already developed. The cabinet was formed weeks before taking office.[113] This meant that the administration could enact substantial changes immediately. On September 3, 1992, less than a month after taking office, the executive devalued the sucre by 35%, implemented a revolutionary exchange rate system, and raised the price of oil derivatives by 300%, electricity rates by 66% and telephone rates by 50%.[114] There were early public commitments to decrease the number of state employees through attrition and by offering redundancy packages. During Durán Ballén's first two years in office the public payroll was reduced by 20,000 people;[115] in contrast, it had increased annually by 13-15,000 for the past 15 years.[116]

Durán Ballén himself is not remembered as a strong president.[117] One observer of the period commented that Durán Ballén lacked energy and conviction that the reforms were necessary,[118] and news reports called him "weak and indecisive".[119] Conventional wisdom, and also several insiders' accounts, indicate that the key proponent of the reforms was Durán Ballén's vice-president Alberto Dahik.[120] Dahik made the economic appointments and, when cabinet members departed, replaced them with technocrats in line with his neoliberal views. Dahik credits his technocratic experience with creating camaraderie and coherence in the economic team and thereby accounting for much of his reforms' success. Unlike previous vice-presidents, Dahik had worked as a colleague with many of the economic team and continued to work at the Central Bank on a daily basis. This allowed him to resolve differences between the MEF and the Central Bank as a fellow economist rather than as the politician in charge. Eventually, Dahik took over the political management of the reforms and left the technical details to his team. The most radical reformers were

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[113] Interview, Sixto Durán Ballén, 4 April 2005, 4pm, Quito.
[114] *Chronicle of Latin American Economic Affairs* (1994).
[115] US Department of State (1994).
[116] Figures given to me by former President Sixto Durán Ballén in interview, 4 April 2005, 4pm, Quito.
[117] He put his own reform success largely down to "a tremendous amount of personal effort of the team". Interview, as above.
[118] Interview, Blasco Peñaherrera, former Vice-President of Ecuador, 6 April 2005, 1pm, Quito.
[119] *Latin American Affairs* (1994).
[120] Dahik himself agreed: "I think that the weight of the government was on my shoulders". Interview, Alberto Dahik, 1 September 2005, 3pm, San Jose, Costa Rica.

politically protected by Dahik, a member of his team said, allowing the programme to maintain its coherence and efficiency.[121]

Legislative opposition

Durán Ballén lacked congressional support throughout his term. Initially supported as a candidate by the tiny Partido Republicano and Partido Conservador, his bloc of 19 (of 82) legislators was reduced to less than twelve within his first few weeks and at no time during his presidency could he count on the support of more than one-third of Congress. Given this, the administration developed two strategies to pass its legislative reforms, both dependent on a high degree of executive capacity. The first has been discussed; by the time much of his support had eroded, Durán Ballén had already passed many significant reforms. However, not all reforms were made at the start—for example, the legislation paving the way for the privatisation of 160 state entities was introduced in February 1993 and not approved until September 1993, and financial sector reforms, changes to the Central Bank, and the abolition of several institutions under the Vice-Presidency were well into Durán Ballén's third year.[122] These were hard to pass. Although in theory throughout the Durán Ballén administration the majority of the Congress were 'right wing' supporters of privatisation and small government, in reality they opposed each proposal. The largest party, the PSC, argued it had to pay a political price for agreeing with the government, despite claiming virtually the same political ideology as Durán Ballén. The government therefore developed a second strategy: in exchange for supporting reforms through Congress, the government gave the PSC-controlled sectional governments large amounts of extra-budgetary transfers for public works. As an additional personal incentive, some of this money was routed through PSC members of Congress.[123]

Societal veto players

Initial public approval of Durán Ballén was very high—according to one set of polls, 70% (as compared to his predecessor Borja's 18% and his successor Bucaram's 54%).[124] Durán Ballén (and other interviewees) ascribe this to the goodwill and

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[121] Interview, Augusto de la Torre, 16 September 2005, 10am, Washington.
[122] *Latin America Regional Reports* (1993).
[123] Interviews, insiders during Durán Ballén administration.
[124] *Latin America Regional Reports* (1994).

credibility he generated in his previous positions, especially as Mayor of Quito. However, the first weeks' high approval ratings quickly faded and the media began to oppose Durán Ballén's reforms. At this stage the commitment of the government to the reforms was instrumental. (In Durán Ballén's words, "We decided not to pay attention to the press.") Among other symptoms of discontent, in 1993 the National Union of Educators, which represents 130,000 teachers, struck against the government for 63 days. Durán Ballén's response was authoritarian: sending in the armed forces, authorising tear gas, dismissing leaders, imprisoning teachers and militarising schools.[125] Two external shocks added pressure: an expensive border war with Peru, and a natural disaster in the Paute river in Cuenca which blocked electricity for months. Growing societal opposition slowed the pace of reform and, just like later governments, vested interests and their representatives in Congress attempted to block reforms. They were often successful, notably with privatisation. However the major disruption to reform momentum emanated from within the administration; a series of corruption scandals culminating in a political process against Dahik. Towards the end of his term Durán Ballén initiated a referendum to approve several liberalisations. It was too late, however, and the corruption scandals turned the referendum into an evaluation of his administration as a whole, inevitably producing a clear 'no' vote.

Because societal and legislative support dropped throughout Durán Ballén's presidency, Durán Ballén achieved most reform in his 'honeymoon', the initial stages of a presidential term often recognised as ripe for reform (see Chapter One). On gaining office, Ecuadorian presidents typically have high approval ratings following populist campaigns. It generally takes a few weeks before the public realises the promises cannot be fulfilled and approval falls dramatically, remaining low for the remainder of the term. Additionally, presidents tend to inherit poor economic conditions, due to the low incentive to maintain fiscal discipline at the end of the previous president's term. This is because Ecuadorian presidents at the end of their term are almost always deeply unpopular, have made and broken several coalitions in Congress and are therefore vulnerable to political challenges. If at this stage, for example, doctors and oil workers strike simultaneously, there is a strong incentive to raise their wages and thus survive to the end of the term, passing the costs on to the

[125] Miranda (2003).

next president. Incoming presidents thus have a motive to reform and also a short window of time to ignore protests and pass reforms.

'Honeymoons' are a well-documented feature of democracies, but in Ecuador they tend to be particularly short, as indicated by public opinion poll data.[126] Table 4.3 draws on published polls for several Ecuadorian presidents to show approval ratings during their terms. Although this data comes from various polling companies and should be used with caution, the general trend is clear. Most presidents take office with high public support, which diminishes and—except for minor fluctuations—does not recover.[127] The three ousted presidents (Bucaram, Mahuad and Gutiérrez) had less than 5% support on departing office, and even those presidents which served out their term had much lower support in the latter stages of their terms. Some presidents faced precipitous falls in popularity (Bucaram, Durán Ballén), others had a more gradual erosion (Gutiérrez and, less conclusively, Noboa). One, Borja, had very low support on assuming office. For Mahuad, the honeymoon was at least six months long; for Gutiérrez it was at least two, but could have been up to six; for Durán Ballén and Bucaram it was certainly less than four, and Borja seems not to have had a honeymoon at all.

Ecuador's presidential approval curve is clearly low and steep. The full presidential term is 48 months; the *best* case revealed by available data is Noboa, who had only 22% support after just 29 months. Rather than the six years a Mexican president has in office, an Ecuadorian president has just four—and terms actually *served* by Ecuadorian presidents are shorter still.[128] Rather than the low of 30-40% an American president might experience, Ecuadorian presidents regularly poll less than 10% while in office (as did four of the seven presidents in table 4.3).

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[126] Public opinion data reflects only societal support, but this is closely linked to legislative support. Legislative support can influence popular opinion by shaping the image of the president as strong, weak, effective or helpless. In turn, popular support influences legislative support in two ways: legislators may change their allegiance to reflect public opinion as the president loses popularity, and individual legislators continuing to support the president regardless of his unpopularity are often voted out in midterm elections.

[127] Mejía-Acosta, Araujo *et al.* (2004:52) produce a similar result by averaging monthly polling data.

[128] Most Latin American presidential terms are four, five or six years.

Table 4.3: Approval ratings of presidents since 1988 (% of polled 'approving')

Months since assuming office[129]

President	0	0.5	2	4	6	7	9	10	11	12	16	23	27	28	29	On Departure
Borja	18			11												
Durán Ballén	70			27			15			10						
Bucaram	54			15	1	-	-	-	-	-	-	-	-	-	-	1
Alarcón	74											-	-	-	-	
Mahuad	71				60						2	-	-	-	-	2
Noboa	50										26	39	32	42	22	
Gutiérrez	64	52	56			31	20	18	16			9	4	-	-	4

Sources: Hoy, Andean Group Report, Spanish Newswire Services, America Weekly Report, Latin America Regional Reports, Intelligence Research Ltd, Associated Press Worldstream, The Economist, Financial Times, Agence France Presse, The Washington Times.

Durán Ballén's honeymoon helped, but a honeymoon is not *sufficient* for reform to occur. This is clear from other administrations' attempts at early reforms; Bucaram had to reverse reforms because political capital fell so quickly due to poor political management, and the Gutiérrez administration very quickly lost public support when it abandoned its two main election platforms (anti-nepotism/anti-corruption and anti-neoliberal reforms). The interim administrations of Alarcón and Noboa had high approval but no real mandate. Clearly, even when legislative and societal opposition is neutralised, executive capacity is still necessary. Furthermore, the end of the honeymoon signals the rise of generalised antipathy to the government and its programmes. In Durán Ballén's case, opposition from Congress and civil society grew too strong to pass any more reforms.

But this was not all. Rather than reforms just *stopping*, *unravelling* or being *undermined*, as with the other three cases in this chapter, the Durán Ballén case left a legacy of instability which would make even unrelated reforms much more elusive. Alberto Dahik's departure in October 1995 under a cloud of scandal was a turning point both for the Durán Ballén administration's reform agenda and for Ecuador's political institutions more generally. His flight from Ecuador into exile not only had the short-term effect of halting the reforms he was promoting, but was also the

[129] Gaps indicate no available published data. Few polls were published for earlier Presidents, and only one for interim President Alarcón. Dashes indicate the president was no longer in office.

beginning of the erosion of the institution of the presidency and vice-presidency. In the long term, it demonstrated the ease of vetoing reforms and thus created many more veto players who could credibly threaten an administration. Thus the Durán Ballén administration was the last to achieve significant reform partially because it left a legacy which would make it much harder for its successors.

The PSC had not reacted strongly to the neoliberal policies Dahik had promoted, other than extracting the maximum concessions in order to pass them through Congress. However, when Dahik attacked the PSC itself, they took action. On 5 July 1995, Dahik began to publicly reveal the corruption that he had, until that time, been part of. He began to denounce the PSC in newspapers and on television, detailing their 'blackmail' attempts and saying his administration had been "forced to pay bribes to deputies and judges to implement government policies".[130] In response, the PSC brought impeachment proceedings against Dahik. Although these failed in Congress, two PSC members filed charges with the Supreme Court (despite the Constitution's provision that they must first pass through Congress) and Dahik was found guilty.[131] Rather than protest the unconstitutional procedure, Durán Ballén at this stage left Dahik to his fate. He asked Dahik for his resignation, which was duly offered (with three cabinet ministers resigning in sympathy), and Dahik accepted asylum in Costa Rica and remained there for the next ten years.

This opened a door which has never been closed. The constitutional requirements to oust a vice-president are the same as those to oust a president, so having accepted the precedent of Dahik's departure, it became simple to remove a president by means of the courts—or the PSC, which controlled the courts throughout the period considered in this thesis. From Dahik onwards, every single president of Ecuador has been either impeached, jailed or sent into exile: Bucaram, declared 'mentally incapable' by Congress in 1996 (although no medical evidence was presented); Alarcón, jailed for two years in 1998; Mahuad, exiled in the United States in 2000; Noboa, exiled in the Dominican Republic in 2002; Gutiérrez, in 2005 declared by Congress to have 'abandoned his post' as president even though he was in the Palace at the time and had issued an executive decree an hour earlier. In several of

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[130] *Latin American Political Affairs* (1995). In an interview, Dahik emphasised the PSC's rent-seeking in return for supporting reforms as the reason for his denunciations. Other interviewees who were involved during this period felt that Dahik also had a larger goal of reducing PSC dominance of the political system more generally.
[131] Larrea (2004).

these cases there were major irregularities regarding presidential succession. Bucaram, for example, was not replaced by his Vice-President Rosalía Arteaga but by the President of Congress (Alarcón), while Arteaga remained Vice-President. Dahik's unconstitutional removal demonstrated that the constitution could be ignored at will, and that the PSC's control of the judiciary was sufficient to bring criminal charges against those the PSC wanted out of the way and to force them into exile. Over the next decade not only presidents, but many others—ministers of economy in particular—were forced into exile in this manner. Many are now occupying posts in the IMF and World Bank in Washington.

In an interview, Dahik said that he never thought that he would be exiled; that is, that his removal was not a credible threat.[132] Before Dahik's fall, no vice-president had been subject to impeachment, and every government since 1979 (that is, since democratisation) completed its term. Afterwards, however, none has done so. After the dramatic removal of Dahik from Ecuador, it was clear to all that the PSC could offer credible threats and thus act as a veto player over policy even when it did not form part of a majority coalition in Congress. As he said, "After my fall, the PSC realised that through the control of the judiciary they can get rid of anyone. So that's what they've been doing."[133] Moreover, other players began attempting—and succeeding—overthrows.

Conclusion

This chapter addressed a two-part question: How were Ecuador's rare examples of reform successes achieved... and were they really successes? To answer the first part, I hypothesised that successful implementation was only possible when a capable executive could avoid or overcome legislative and societal opposition. To answer the second, I considered what happened after implementation, especially whether the reforms met the other two measures of success: endurance and achieving their stated aim. Findings were made on both points.

Firstly, we saw that implemented reforms did avoid the pitfalls of executive incapacity and legislative and societal opposition, evidence consistent with the hypothesis advanced in Chapter Three. Each of the reforms discussed in this chapter

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[132] Dahik was thought of as "the most powerful man in the country" at the time (Larrea 2004).
[133] Interview, Alberto Dahik, 1 September 2005, 3pm, San José, Costa Rica.

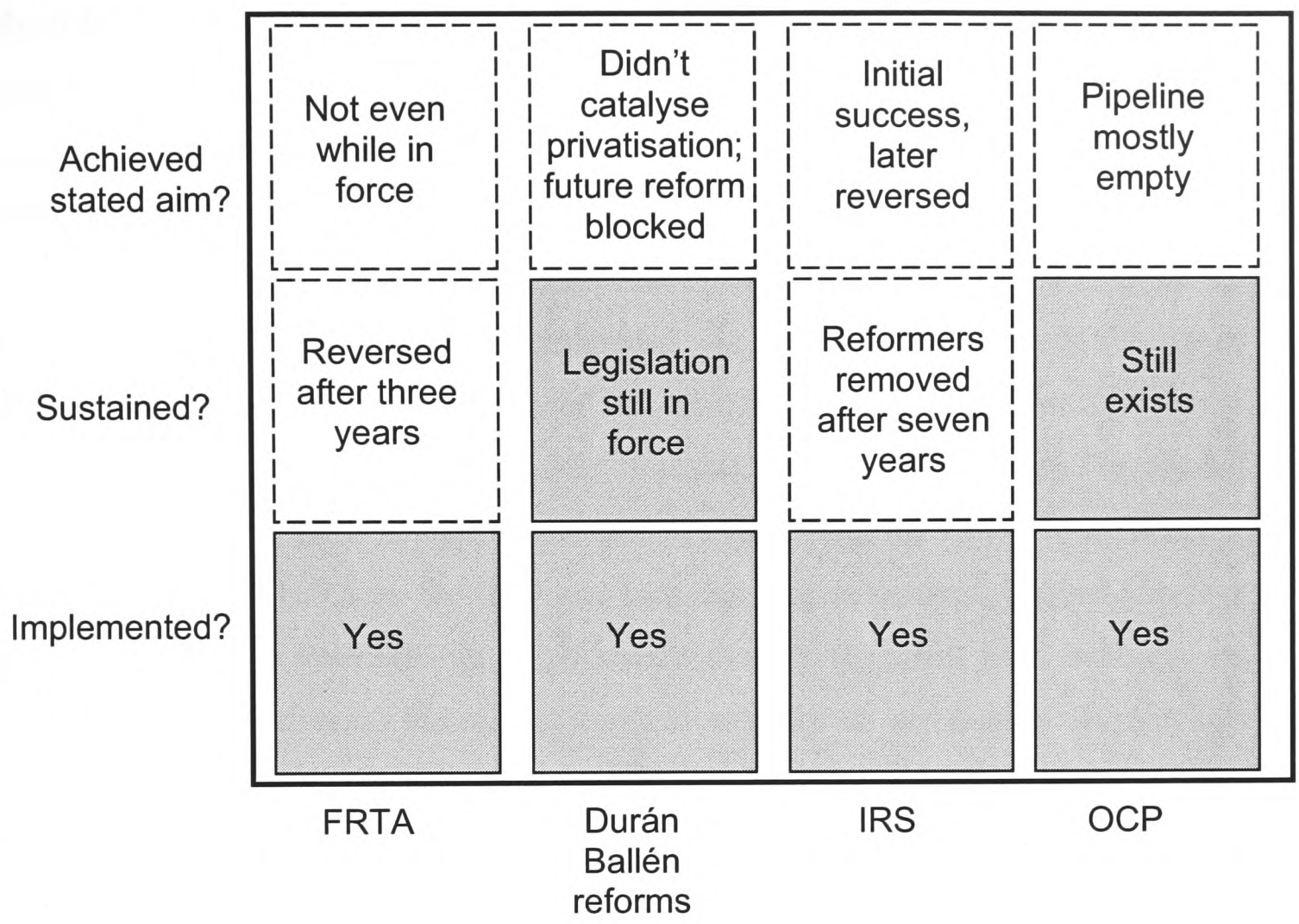
was implemented because of a coincidence of unusual factors enabling reformers to overcome the usual obstacles. In each case, the legislature was temporarily relatively powerless and societal opinion was temporarily in favour of reform. Durán Ballén was able to introduce reform during his honeymoon, due to unusually high executive capacity which allowed him to hit the ground running. In the other three cases, just as the literature predicted it might, crisis seems to have created coalitions for reform, brought 'learning effects' and encouraged sacrifices. In the OCP and FTRA cases, enabling legislation was passed during crisis, when the legislature was amenable. The crisis also made it easier for OCP Ltd. to persuade Ecuadorians to support the pipeline. In the tax case, Elsa de Mena was appointed to raise revenue when crisis was imminent.

A second striking element of the 'successes' is that three of the four were driven by a single individual: the Durán Ballén reforms (Alberto Dahik), the IRS (Elsa de Mena) and the OCP (Pablo Terán). The chapter therefore seems to show that although strong individuals working alone cannot work miracles—other strong personalities in the recent past have been unable to implement reforms—they can achieve implementation with adequate background conditions. In particular, each of the three reforms had an unusual degree of functional autonomy. To protect this, they needed high-level (e.g. national executive) support to insulate them from Congressional interference, including threats of removal. This executive commitment could be created or increased by crisis (as above), or by multilateral or public support: the FRTA was pushed by multilaterals, Terán increased his own support by running a PR campaign, and de Mena's reputation of integrity and high-profile anticorruption battles captured media coverage. In the final case, the executive (via Dahik) was ideologically committed to the reforms *ex ante*. Finally, either legislative opposition must be absent, or the executive must be strong and stable enough to weather it.

These background conditions allowed reformers to overcome initial obstacles to implementation, but *no reformer could sustain the reforms or ensure they achieved their stated aim.* As we saw in this chapter, each of the four cases were undermined or reversed. Reforms could be undone when the crisis receded (Elsa de Mena's dismissal) or undermined because they were lone 'islands of efficiency' (the IRS, the FRTA, the OCP). Figure 4.11 summarises the way each implemented reform was

either reversed or undermined, or both.[134] Shaded segments represent 'success' according to the element in question, light segments 'failure'.[135]

Figure 4.11: Elements of success in four relative 'success stories'



As we saw above, the IRS was re-politicised, and Elsa de Mena and her administrative team dismissed. In the case of the OCP, private oil firms were aghast at the VAT decision, and subsequent threats to nullify their contracts exacerbated the perceived juridical risk of operating in Ecuador. Private production failed to increase to predicted levels and thus, two years after the OCP was built, both it and the SOTE were half-empty. The FRTA fared better, lasting for the entire Gutiérrez

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[134] In Chapter Three, we noted a successful internal reform of Andinatel. It is worth noting here that this corporate restructure, too, was eroded. Under the Noboa administration, Andinatel was successfully depoliticised, but the Gutiérrez administration began to re-politicise it. The day Gutiérrez arrived in office, Andinatel's entire Board of Directors resigned. The new government dismantled the team of technical staff that the previous Board had formed, including vice-presidents and managers. Some new Board members were clearly linked to the PSP (for example, Andinatel's new President, the First Lady's sister). Others were linked to the PSC or PRE. On 26 April 2004, six days after Gutiérrez was ousted by Congress, the executive president of Pacifictel resigned, indicating the rest of the Board of Directors would do so too in the next few hours. In theory, Andinatel is an independent private company merely owned by the state; this mass resignation demonstrates its politicisation. See Ecuadorinmediato (2005).

[135] 'Sustainability' can never be conclusive; this chart represents May 2005, the month after the period covered by this thesis.

administration. But although it persisted in name, in practice it began to be undermined almost immediately it was passed. The Durán Ballén reforms added an extra element. Durán Ballén's reforms persisted but much of the legislation he initiated was never implemented. Furthermore, Dahik's exposure of the means by which the legislation passed began a chain of events which has undermined reforms ever since. The failure of Durán Ballén's reforms to achieve their stated aim of catalysing further reform thus has two parts. Not only did they fail to catalyse specific reform legislation, but more significantly, they *blocked* further reform.

The underlying problem is the lack of a supportive policy/institutional framework in which reforms can be embedded. Any reform requires such a focussed effort that other reforms must be delayed; to attempt more than one at once seems to ensure failure. But, paradoxically, in order to embed reform, other reforms are needed simultaneously. The OCP is a good example of this: to win the battle to construct it, Terán had to focus 100% on the OCP and thus delegate an unusual amount of power to the President of Petroecuador. This meant that Terán made little headway on signing new oil contracts, increasing juridical stability or developing partnerships between Petroecuador and private firms. While the Ministry of Energy did send reforms to Congress, Terán's scarce political capital was needed elsewhere and all proposed reforms failed. Meanwhile, it was during Terán's period in office that Elsa de Mena, attempting to raise tax take, imposed VAT obligations on foreign firms. All these factors dampened or actively discouraged investment in Ecuador's oil sector. As a result, the OCP has persistent excess capacity. The OCP is still there, but the cost-benefit arguments made by Terán and the oil companies prior to the OCP's construction were predicated on flow-on benefits from employment and oil revenue which have not materialised.

In some of the cases, the reform process itself affected reforms' sustainability. This chapter has highlighted three aspects of this. Firstly, the cases showed that 'buy-in' is a necessary but not sufficient criterion for sustainability. The FRTA never got buy-in from those it would affect, and so was undermined. Meanwhile, however, de Mena had abundant societal buy-in, but was dismissed because she lacked high-level support. Tsebelis argued that the more veto players there are, the harder it is to change policy but also the more stable and irreversible it is once implemented. In Chapter Three, we confirmed Tsebelis' prediction that more veto players make reform harder. This chapter went further, showing that even if veto players can be avoided in

implementation, they can work to reverse or undermine reforms later if their veto power reappears or their preferences change. This leads to the second point: reforms instigated by crisis may not last once the crisis recedes, if high-level support for them is dependent on a desperate need for finance. This is significant because for some reforms (like the IRS) high-level support is as important for sustainability as for implementation. Thirdly, the process of reforming can set important precedents in terms of establishing who may or may not be a veto player. Durán Ballén's reforms ultimately established a new class of veto player. In contrast, the OCP project demonstrated that some players (environmentalists) do not have a veto.

We now know that veto players proliferate in Ecuador, and that their impact on reform is even greater than it appeared at the end of the previous chapter. However, we still have not explored the underlying causes of this phenomenon. Why do veto players proliferate in Ecuador? We have seen hints of the answer in the way Alberto Dahik's dismissal acted as a warning shot to would-be reformers. The next chapter aims to address the question more fully.

Chapter Five: The Source of Veto Power in Ecuador

We have now seen considerable evidence consistent with the hypothesis that reform in Ecuador fails because of chronic legislative opposition, a proliferation of societal veto players able to credibly threaten executive survival, and executive incapacity. Chapters Three and Four established the existence of these three features of the Ecuadorian political system, and examined their consequences. This chapter and the next examine their *causes*. This chapter focuses on the first two features, legislative opposition and societal veto players, seeking to understand why they proliferate, and from where they draw their power. The next chapter will examine the third feature, executive capacity.

A full explanation of the prevalence of veto power in Ecuador involves several distinct parts. In this chapter I need to demonstrate and explain why Ecuador has many players (1) who want to veto (2), each of whom has a method of threatening (3) which is credible (4). I examine empirical evidence and explain each component in turn. Firstly, why are there so many players in Ecuador—in other words, how and why is political power so fragmented? Secondly, why do these fragments oppose the executive (and each other) rather than cooperating? What are the incentives to veto? Thirdly, how does their opposition manifest—what are their tools of opposition? Finally, what makes their threats credible? This chapter takes up each question in turn. Chapter One suggested several factors found in the institutional literature to impede reform: fragmentation, polarisation, clientelism, and a proliferation of undisciplined, unstable, non-programmatic parties. This chapter concurs that these factors do indeed impede reform in Ecuador—by acting as background conditions for veto players to proliferate and prosper.

The investigation begins by discussing Ecuador's major political cleavages. Of course, all nations have social and political cleavages of some sort.[136] In Ecuador, the political forces representing these cleavages tend not to coagulate in sustainable or predictable ways. As a result, Ecuador has a proliferation of political parties and a high degree of fragmentation of political power. The chapter begins with a discussion of what the pertinent Ecuadorian cleavages are and why they have become

[136] Research has long focussed on political cleavages in developed nations (for example, Knutsen 1988, 1986), and has increasingly been supplemented by work on developing and transition states (see Whitefield 2002, Zarycki 2000). Moreno's (1999) multi-region comparison includes several Latin American countries, although not Ecuador.

institutionally entrenched. I then place 'instability' at the centre of an explanation of how a proliferation of societal groups can credibly threaten executive survival. Earlier chapters showed empirically that veto power was dependent on the stability of the executive: Elsa de Mena was dismissed when the executive was vulnerable to legislative attack following impeachment rumours; the zeal for customs reform faded when Pachakutik's support was withdrawn and the government desperately needed a new political alliance; civil service reform was voted down for 'positional' reasons, used as a tool to attack an unstable government; LPG price reform was postponed for many years because governments with a weak grip on power could not risk mass protests; and in the oil sector, unions were able to credibly threaten to bring down the government at some points in the process because it was already so unstable. Explaining how credible threats are made therefore entails explaining why executives are so unstable. Finally, I note the inability of any single veto player to advance a positive agenda. As a whole, the chapter sheds light on why the impact of crisis on reform in Ecuador has not been as positive as the literature might suggest. I conclude that crisis can exacerbate stasis rather than catalysing reform in the long term.

Ecuador has many players

The first question for this chapter is, how and why is political power so fragmented? I begin by outlining Ecuador's major political cleavages. Elsewhere, research on political cleavages has tended to emphasise country cases' idiosyncrasies. Studies of even similar countries within a region have revealed quite different national cleavages.[137] In Ecuador, the most politically-significant cleavages are *wealth*, *region*, *ethnicity* and *patronage networks*. As in most studies of political cleavages, there is some overlap between them, which I highlight.

Let us first consider lines of wealth. Ecuador's economic inequality is remarkable even for Latin America, where societies tend to be highly unequal.[138] Firstly, the economy is (and has been for centuries) dominated by a small number of extremely wealthy Ecuadorians. In the 1950s, Ecuador's wealth was said to be

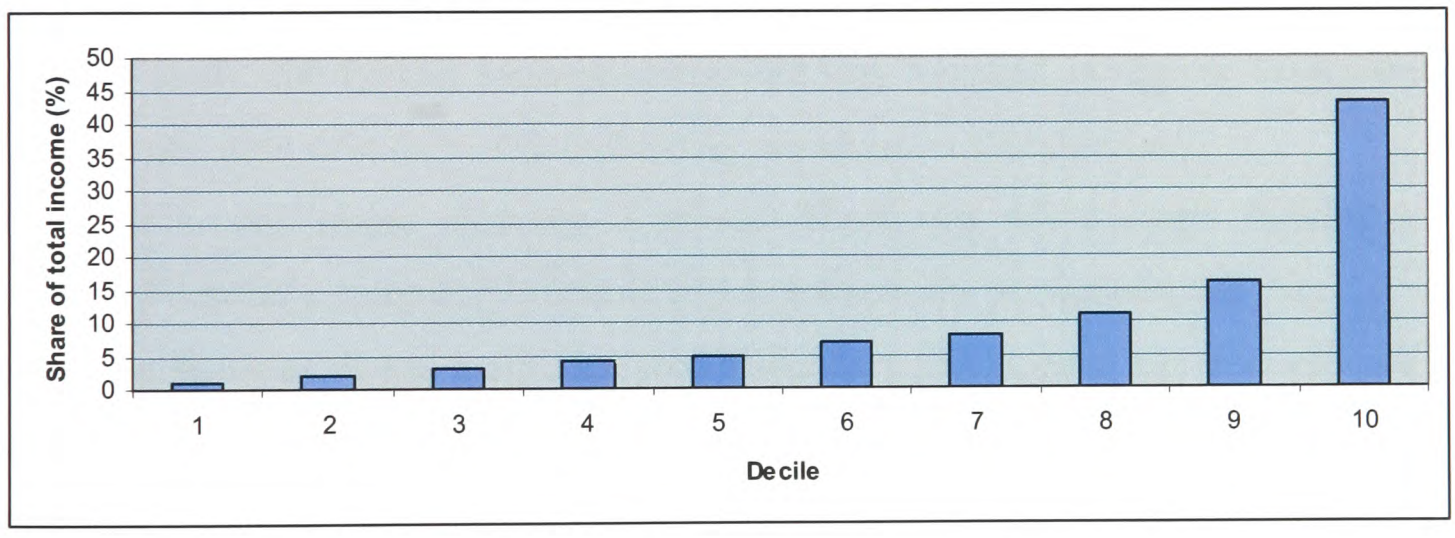
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[137] Considering the two successor states to Czechoslovakia, Evans and Whitefield (1998) found that the Czech Republic divided on distribution and attitudes towards the West, while in Slovakia, the main concern was the ethnic rights of Hungarians. Meanwhile, longitudinal studies of the USA have found cleavages based on 'cultural' factors including region, ethnicity, religion, morality (Rae 1992), or divisions of race, religion, class and gender (see for example Brooks and Manza 1997).

[138] Ecuador's Gini coefficient reveals higher inequality than all of its neighbours (Offerdal 2000:82).

concentrated in the hands of just four families.[139] The oil era of the 1960s and 1970s concentrated income, and, because oil production was administered by the state, intensified the need for connections between powerful economic interests and politically important actors. Taxes were removed or 'forgotten' by the state, which was enjoying a period of unprecedented expansion and prosperity through its share of oil profits. By the end of the oil boom, in the late 1970s, only the middle classes were paying income taxes and the tax system was effectively regressive, further concentrating wealth.[140] During this period, business enterprises frequently sought and obtained state protection, in a series of populist (but regressive) subsidy schemes and soft credits for industrial investors.[141] Little has moderated Ecuador's inequalities since then. Today a tiny minority of extremely rich Ecuadorians—a few individuals and no more than 100 families—sit atop a small middle class and a vast number of poor Ecuadorians.[142] Figure 5.1 shows the disparities in income between rich and poor in 1995. By 2005, the richest 10% of the population received 42% of all household income.[143]

Figure 5.1: Share of total income for Ecuador in 1995



Source: Offerdal (2000: 80). Excludes owner-occupied housing.

State expenditure compounds, rather than reduces, these inequalities. As table 5.1 shows, the poorest 20% in Ecuador receive *less* than 20% of social spending, while in Chile, they receive 33%. Ecuador's richest receive over five times as much as Chile's richest. Ecuador's last World Bank Public Expenditure review, in 2004, found

[139] Freire (2000:29).
[140] Herrera (2000:10-12).
[141] Ratinoff (1967:73). See also Offerdal (2000).
[142] Núñez (2000:9-10).
[143] EIU (2005a).

that about half of total social spending was not 'pro-poor'. Indeed, in 2003 the poorest 20% of the population received just 12% of social expenditure, while the richest 20% received 27%.[144]

Table 5.1: Social spending and income quintiles

Quintile	*Richest 20%*				*Poorest 20%*
	1	**2**	**3**	**4**	**5**
Chile	4	12	20	27	33
Ecuador	21	23	21	18	17

Source: Garnier (2000: 73, 86).

In addition to high inequality, social mobility is low and thus the wealth inequality cleavage is fairly constant across generations. Ecuadorian business elites are overwhelmingly drawn from groups that own capital, and capital-owning families persist over generations. Hidrobo studied 69 Ecuadorian industrialists in detail in 1992.[145] Over 90% had professional training, suggesting they were among the Ecuadorian economic and social elite. Industrialists' fathers and grandfathers were mostly businessmen, landowners, or professionals. None had working-class fathers. In Hidrobo's study, the typical business enterprise was financed by family assets and financial institution debt. 73% still had family members as shareholders.

The second major cleavage is ethnic. There was not a single indigenous worker in Hidrobo's sample,[146] a result which reflects the importance of 'race' as a cleavage in Ecuador. It has long been so: Freidenberg shows how a system of state-sanctioned separatism sharpened the distinction between indigenous and *mestizo* ('mixed') Ecuadorians by means of dual laws, one set of laws for 'citizens' and the other for indigenous Ecuadorians.[147] Although the dual legal system has gone, stark divisions continue today and the racism by 'white' Ecuadorians towards indigenous and black Ecuadorians is widely-documented.[148] Society is deeply divided in terms of skin colour at all levels. Some Ecuadorian elites never interact with a non-'white' Ecuadorian except as a subordinate. This reflects a considerable degree of overlap

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[144] Izquierdo, Melo *et al.* (2004:39).
[145] Hidrobo (1992). Companies were equally divided between Quito and Guayaquil.
[146] Hidrobo notes that this is in striking contrast to other countries such as Japan, where peasants are key participants in industrialization.
[147] Freidenberg (2002a:109-111).
[148] See, for example, Ribadeneira Suárez (2001), De la Torre (1996).

between wealth and ethnicity: 'white' Ecuadorians tend to be richer, indigenous or Afro-Ecuadorians poorer. The two factors should be separated, however, since ethnicity is highly politically salient and, of course, the correlation is imperfect—there are many poor 'white' Ecuadorians as well.

Recent structural changes and responses from the indigenous communities of Ecuador have increased political fragmentation on ethnic lines.[149] In 1995, a constitutional amendment opened the political system to independent movements and candidates no longer had to be affiliated with political parties. Accordingly, in 1996, Pachakutik entered the political realm. It quickly became a significant force. Pachakutik has tried to make itself an umbrella group of the left by incorporating communists, Trotskyites, socialists, environmentalists and women's and other social sector groups. However, in membership, leadership, voting and perception it remains firmly indigenous.

A third major cleavage in Ecuador is regionalism. Ecuadorians' strong regional identities are the product of substantially separate development for over 500 years. In the colonial era, while Spanish colonialists conquered the sierra, they lacked effective control over the coast, which was settled in he south by indigenous refugees from the highlands and in the north by blacks who had been shipwrecked in 1570. Large eastern regions remained unknown to the Spanish until settled by Jesuits in the mid-seventeenth century. Throughout the early days of independence in the nineteenth century, the political forces of the sierra and the coast clashed. This culminated in civil war in 1895 when Eloy Alfaro led the successful Ecuadorian Liberal Revolution from the coast against Quito. Political and economic divergence underpinned the conflict; coastal interests were shaped by large-scale, export-oriented agricultural liberals, sierran interests by small farmers and businessmen, clergy and landowning conservatives. Today Ecuador still manifests stark regional divisions based on similar interests. Ecuadorians tend to identify very strongly with their region, and to highlight their differences of temperament and custom.

Ecuador's regional division of power can be seen in a raft of contemporary electoral data at all levels of governance. Jones and Mainwaring (2003) found Ecuadorian parties were the most regionalised in Latin America. The major political

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[149] Freidenberg points out that the incorporation of indigenous sectors into the political arena did not create a new social tension, but rather is the political manifestation of a long existing cleavage (Freidenberg 2002a:131).

parties have all always been strongly associated with particular regions; there is no national party. Over a 20 year period, provincial representation was divided up by the major parties along regional lines. As table 5.2 shows, the PRE and PSC are clearly parties of the coast, while the ID and DP are clearly parties of the sierra. Pachakutik wins in provinces with high numbers of indigenous voters, notably the Amazon (again, a point of overlap between cleavages). At the Presidential level, the second round of voting virtually always pits a coastal candidate against a sierran candidate. In 2002, Gutiérrez' support was dominated by Amazon and sierran votes, while Alvaro Noboa clearly won on the coast.[150]

Table 5.2: Provincial representatives for the four major parties, 1978-98

Party	Sierra	Coast	% total seats held in Sierra
PRE	18	62	23%
PSC	43	78	36%
ID	76	21	78%
DP	44	10	81%

Source: Freidenberg and Alcántara Sáez (2001)

This regionalism at the national level is reinforced at the level of sectional government. Firstly, as table 5.3 shows, the PRE, ID, DP and Pachakutik have highly concentrated support. Only the PSC is strong in both the sierra and the coast at the sectional level. Secondly, regional institutions tend to have much more support than their national counterparts. One illustration of this is that regional mayors are consistently much more popular than the national leadership. In September 2003, for example, almost 80% of Ecuadorians said they distrusted national government and felt pessimistic about the regime; Gutiérrez received personal ratings of 22% (popularity) and 21% (credibility and approval). In contrast, Mayor Jaime Nebot of Guayaquil had 86% approval ratings in the same month, and Mayor Paco Moncayo of Quito had 57% approval.[151]

[150] EU (2002:3).
[151] Gestión (2004a).

Table 5.3: Prefects and Mayors of provincial capitals, 1978-2000

Party	Sierra	Coast	Amazon	Support concentrated in
PRE	1	24	4	*Coast*
PSC	17	11	4	*Sierra and Coast*
ID	35	7	14	*Sierra and Amazon*
Pachakutik	4	0	3	*Sierra and Amazon*
DP	13	2	6	*Sierra*

Source: Freidenberg (2002b:47)[152]

Regionalism is also reinforced by civil society, including quasi-constitutional bodies. The chambers of commerce, for example, are regional, rather than national. Industries and patronage networks (see below) are distributed regionally. The 'godfather' of the coast and the leader of the PSC, former President Leon Febres Cordero, has always identified strongly with certain sectoral interests of coastal business, effectively preventing the PSC from becoming a truly national party.[153] Business culture also differs regionally—the coast is more 'informal' than the highlands and, typically, carries higher credit risk.[154] In Chapter Four, we saw a clear example of the regional differences between Guayaquil's Pacifictel and Quito's Andinatel.

Regionalism is 'real' in that regionalist attitudes and differences are clear from paired comparisons, opinion polls and voting records. But regionalism is also used as a tool to promote specific interests and to block reforms. In Chapter Three, we saw how regionalism was used to block electricity privatisations, and how the Noboa administration attempted a regionalist strategy for reform by sacrificing Pacifictel to appease the Guayaquil elite, in exchange for concentrating its political efforts on the electricity privatisations (which then failed). Arteta and Hurtado describe how during the banking crisis, the Mayor of Guayaquil repeatedly declared that the coast would 'rise up' against 'Quito centralism' if the coastal banks were closed. The threats temporarily achieved their goal: the Superintendent of Banks delayed intervening long enough for "outrageous corruption", as bankers transferred funds, destroyed

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[152] Sierran strength of the ID, Pachakutik and DP is underrepresented, as they also share five mayoralties which do not appear above.
[153] See Gestión (2004c).
[154] Interview, commercial banker, April 2005, Quito.

documents and fled the country. Once it was too late to take corrective measures, the banks failed.[155] The spectre of 'centralism' was also invoked against the customs reforms in Chapter Three. An integral part of the proposal to bring customs under the IRS was moving it from Guayaquil to Quito. This intensified the resistance of coastal parties to the reform, as they and the business interests they represent would have still less control over customs if it were physically moved outside their patronage networks. Personnel, for example, would likely be Quito residents with no party links to the coast. The relocation proposal made an argument available which the parties used extensively: they called the proposed reform 'centralisation', contrary to the goal of 'decentralisation' enshrined in the constitution.[156] These events demonstrate how interests are conceived of by elites regionally; groups agitate not for policies that benefit wealthy elites, but wealthy *Guayaquil* elites, or wealthy *Quito* elites.

Regionalism is increasing, both in terms of citizens' expression of their primary identity and in the allocation and division of government resources. Ecuador's autonomous sectional governments receive earmarked transfers from the central government, and also have their own sources of revenue.[157] A strong movement, emanating from Guayaquil as it responds to its loss of economic power following the crisis,[158] aims to further devolve power and financing from national government to the sectional governments. 'Decentralisation', a principle enshrined in the constitution, was a key pillar of the Durán Ballén administration's attempts at institutional reform.[159] Additionally, in recent years, as indigenous groups have gained strength, some have begun campaigning for semi-autonomous ethnic homelands.[160] Such regionalist tendencies both reflect a lack of faith in central government and also further weaken it by drawing resources away from the centre.

The final major line of fragmentation traces the boundaries of patronage networks in the phenomenon of 'clientelism'.[161] In a clientelist system, 'patronage

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[155] "Encased in regionalist talk, special interests, though political parties and leaders, have often obtained support to obstruct sound policies seeking the national interest" (Arteta and Hurtado 2005:166).
[156] See *El Comercio* (2003g), Oleas (2004:67).
[157] In 2003, transfers to these regional authorities represented 2.4% of GDP (Izquierdo, Melo et al. 2004: 54).
[158] Most of the failed banks were located in Guayaquil, as were the export industries hit hardest by the crisis.
[159] Interview, Galo Abril, Minister of Planning (1993-4), 1 April 2005, 4pm, Quito.
[160] EIU (2005b).
[161] For a beautifully clear history of Latin American clientelism and the development of patronage networks, see Taylor (2004:213).

networks' link one or a few associated 'patrons' to many 'clients' and typically mediate the relationship between an individual and the state. Membership of a healthy patronage network facilitates clients' access to state goods and services. In turn, clients offer loyalty, votes and sometimes services. In practical terms, this can mean a village receives electricity, a family never receives a telephone bill, a job becomes available at the local port, or a court case is resolved in the defendant's favour. Although, as Legg points out,[162] clientelist relationships exist to some degree in all modern societies, [163] in the literature clientelism is frequently contrasted with citizenship in advanced liberal democracies in which access to social resources is predominantly based on universalistic criteria and anonymous equality before the law.[164] The pervasiveness of clientelist networks is generally incorporated into the measurement of aggregate 'corruption' in cross-country studies, which typically find it to be widespread and pervasive in Ecuador.[165]

These patronage networks are the modern-day manifestation of an old tradition of Latin American paternalism. While the Ecuadorian state is designed along modern anonymous, unbiased lines, it has been superimposed on a deeply personal, quasi-feudal system whose morality and practices have endured. In Ecuador, loyalty, familial obligation and reciprocity still tend to triumph over the morality of equality and anonymity before the law.[166] For the oligarchy, this is joined by a strong shared sense of superiority and entitlement. This history and these enduring attitudes underpin the patron-client relationship. A key assumption is patrimonialism: the idea that public resources can be used as private property by those who hold a special entitlement.[167] Just as the feudal oligarchy protected their slaves or workers on the

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[162] Legg (1975).

[163] And some definitions of clientelism are extraordinarily wide, such as Fox's (1994): "a relationship based on political subordination in exchange for material rewards."

[164] Legg (1975), Roniger and Günes-Ayata (1994), Fox (1994), Kourvetaris (1999), Hallin and Papathanassopoulos (2002).

[165] For example, Transparency International consistently ranks Ecuador among the world's most corrupt nations. In Transparency International's Corruption Perceptions Index 2004, Ecuador ranked 112th out of 145 countries surveyed and received a score of 2.4 out of 10, where 0 is highly corrupt.

[166] In Ecuador, "Corruption is normalised and is not considered 'amoral'; it develops within an ethical system of reciprocity, gratitude, familial loyalty, social deference, and is inspired by a universal ethic which differs from either republican morality or the rational universalism of democratic modernity" Bustamante (2004:72).

[167] At times this attitude was reflected in interviews, such as when elites' comments on the election of two populist Presidents revealed the gap between their self-image and their image of their fellow Ecuadorians. One exclaimed regarding Gutiérrez: "This is a family from the jungle!" Another said, "Gutiérrez said in an interview once that he had never read a novel. Imagine! In other countries these people, Gutiérrez and Bucaram, would be bus drivers or barmen, here they are Presidents!" Bucaram was seen as primitive, crude and uncultured (unlike Dahik, Durán Ballén and Febres Cordero, who

Ecuadorian *hacienda*, today's oligarchic discourse revolves around the provision of employment, and the belief that big business should be subsidised because it attracts investment and thereby provides jobs.[168] In line with this belief, in past crises—most dramatically the banking crisis of the late 1990s—the capture of the state by the oligarchy allowed it to 'socialise' its losses. Quito Professor Fernando Bustamente sums up the mindset (without condoning it):

> "It's *us* who provide jobs. It's *us* who bring modern neighbourhoods and technology into the country. We are badly needed because without us, these people will be living in utter barbarism. These poor people need us and we are doing good for them. By the way, we are doing good for us, but that's incidental, that's a just reward. It's deeply ingrained, a civilisational duty. We are the vanguard, the beachhead of a Civilised West amidst barbarians—'barbarians' meaning 90% of the people. The people are different, darker, less European, they must be brought into civilisation by us. In absolutist times it was through missions, now it's done through modernisation and growth. We gave you the evangelicals in the 16th century, now we give you vacuum cleaners."[169]

Patronage networks are sustained by their own internal logic. They survive because they increase the welfare of individuals incorporated into the system, even though they also debilitate the state and decrease aggregate welfare. At the same time, absent a strong push back (an anti-corruption drive, for example), the system of networks tends to spread and co-opt more members since networks' existence and function is well-known and the benefits of membership clearly visible. The lack of belief in communal action as a means to resolve problems, except by means of one's patronage network, becomes a vicious cycle as those who lack protection are made to feel their vulnerability and forced to seek out a patron. The system thus arises from a

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studied overseas), and prone to cavorting with girls "like in Africa". The belief in the educated oligarchy's superiority over such 'primitive' Ecuadorians goes some way to providing a (largely unspoken) social justification for state capture among Ecuadorian elites.

[168] Even jobs for children—in the midst of a scandal over child labour in hazardous working conditions on Alvaro Noboa's banana plantations, Simon Canarte of the banana growers' association retorted: "Just because they are under age doesn't mean we should reject them, they have a right to survive" (*The Economist* 2002).

[169] Interview, Fernando Bustamante, Professor, University San Francisco Quito, 16 March 2005, 10am, Quito.

deep lack of confidence in the state and simultaneously weakens state institutions by decreasing transparency and locating true political power outside of the state apparatus.

The perceptions underpinning the system are reflected in large-scale comparative values surveys such as the LatinoBarometer, which shows that Ecuadorians tend not to trust the state or the democratic process and also feel powerless as individuals. Moreover, most of these trends are worsening. The LatinoBarometer reveals that confidence in Ecuadorian political parties decreased, from 20% in 1996 to 10% in 2002.[170] Of all institutions included in the study, reported respect was lowest for Congress, political parties and the judiciary. Across various formulations of the question and considering various aspects, the 2004 LatinoBarometer consistently shows that Ecuadorians have some of the lowest levels of faith in democracy in the continent.[171] Support for specific administrations has been very low, even by Latin American standards, and Ecuadorians feel powerless to improve their democratic system. In 2004, 77% of Ecuadorians agreed or strongly agreed that the country was governed for the benefit of a few powerful interests, rather than for the good of the public as a whole.[172] Overwhelmingly, even in 2004—three years after the crisis—92% of Ecuadorians thought that Ecuador was going in the "wrong direction", equal highest in Latin America. Less than half (45%) of Ecuadorians agreed that one's vote has the power to change things in the future, the second lowest in Latin America. Accordingly—and despite compulsory voting—only 26% of Ecuadorians would vote if an election were held 'this Sunday' (in 2004), also the second lowest in Latin America. As these data show, perceptions of helplessness and of others' enrichment through clientelism are strong and increasing. This is both a cause and a consequence of the strength of patronage networks.

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[170] Percentage of respondents with 'some' or 'a lot' of confidence.

[171] Ecuadorians had some of the lowest levels of agreement with statements such as: 'Although democracy can have problems, it is still the best system of government'; "Democracy is the only system by which Ecuador can develop" and "Democracy is a form of government where things are resolved by debate and compromise". Ecuadorians' support for democracy as an abstract concept has consistently been in the bottom half of Latin America from 1996-2004. In 1997 it fell to 41%, the lowest in Latin America. Since 1997 Ecuador experienced the greatest fall in satisfaction with its existing democracy (equal with Peru): a decrease of 20 percentage points between 1996 (34%) and 2004 (14%).

[172] By way of comparison, only 34% of Argentineans had this opinion. Only 20% of Ecuadorians approved of the Gutiérrez administration in 2004, the third lowest and much less than the Latin American average of 42%.

The key line of fragmentation of political power for our purposes is *between* patronage networks.[173] This cleavage shapes the way parties are formed and interact in Congress to such a degree that activities in Congress cannot be understood without knowledge of the important networks and their alliances. With few exceptions, parties in Congress are non-programmatic.[174] Ecuadorian parties' ideology is fluid and pliable, arising from their basis in patronage networks rather than class fractions as in the Western Europe model. Instead of promoting a conception of a universal good, they act as conduits to redistribute state resources, and are a key locus of exchange between the client and patron. Parties aim to place their members in key positions throughout the state, both as a favour to the individual, who secures a lucrative source of further favours for his or her own personal network, and also as a means of extending the party's reach and ability to offer credible threats and rewards in the future. Several parties are vehicles of particular family networks, and most of the major parties have a charismatic 'godfather' as leader. Patronage networks and thus parties are often organised along the regional lines seen earlier, which reflects and exacerbates the regional division of political power. Several of the largest parties are populist, their campaigns based on publicity stunts and implausible promises.[175] By eschewing specific policy statements in campaigning, populism fits comfortably with such parties' basis in patronage.

We have now seen the four main ways power is fragmented in Ecuador: along lines of wealth, ethnicity, region and patronage network. This fragmentation is reflected in Congress, which, as we have seen, contains parties of various stripes.[176] Some of these lines have more impact on the shape of Congress than others. Several significant parties are split on patronage networks and region, fewer on ethnicity and wealth. Of course, as we have seen, players can exercise veto power without having legislative representation. The sierran unions are often represented by the ID party, but not always. The military does not have a strong advocate in Congress. Indigenous groups have exercised a veto both inside and outside of Congress. The fragmentation

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[173] Another line of fragmentation is within the networks, between patrons and clients. This overlaps with the wealth division considered earlier.

[174] A 2006 IDB study found that Ecuador's parties were among the least programmatic in Latin America, scoring 1 on a scale from 0 to 8 (Stein, Tommasi et al. 2006).

[175] Former President Abdalá Bucaram campaigned in a Batman suit. On occasion he would pose as the child of Christ fighting "the devil," and use an effeminate voice while describing his opponents as "lukewarm men" with "watery sperm" (de la Torre 1997). De la Torre claims, "To some degree, every politician after [democratization] has been a populist regardless of their political leanings."

[176] For a comprehensive study of the major parties since democratisation see Freidenberg (2003a).

inside Congress helps increase the veto power of these extra-legislative groups because an executive which is unstable for *any* reason is less able to withstand an external threat to its administration, meaning credible threats are easier to make. Fragmentation within Congress thus facilitates a proliferation of veto players even outside Congress.

In Giovanni Sartori's classic taxonomy, a system with more than six effective parties is 'polarised'.[177] Ecuador's Congress clearly falls into this category.[178] After democracy was introduced in 1979, Ecuador experienced a proliferation of political parties which never matured into a programmatic party system. Mejia-Acosta, Araujo et al. call Ecuador's system the second most fragmented in Latin America, after Brazil.[179] At the level of sectional government, 28 different parties or alliances captured at least one prefecture or mayoralty between 1978 and 2000.[180] In the national and provincial elections, a staggering 39 distinct parties won representation between 1979 and 2002. Of these 39 parties, eleven have held over 10% of seats in a Congress, and five have held over 20%. A 'long tail' of parties have held no more than one seat at a time (24 of them). In the elections of 2002, the last legislative elections held, 14 parties won representation, plus 11 more combinations of fragments of those parties, making 25 units before even considering independents. The largest party held (and still holds) less than a quarter of all seats (see Table 5.4).

Table 5.4: The fragmented results of the 2002 National Congress Elections

Partido Social Cristiano	PSC	24
Partido Roldosista Ecuatoriano	PRE	15
Izquierda Democrática	ID	13
Partido Renovador Institucional de Acción Nacional	PRIAN	10
Joint list of PSP and MUPP-NP		6
Movimiento Unidad Plurinacional Pachakutik - Nuevo País	MUPP-NP	5
Democracia Popular-Unión Demócrata Cristiana	DP-UDC	4
Movimiento Popular Democrático	MPD	3

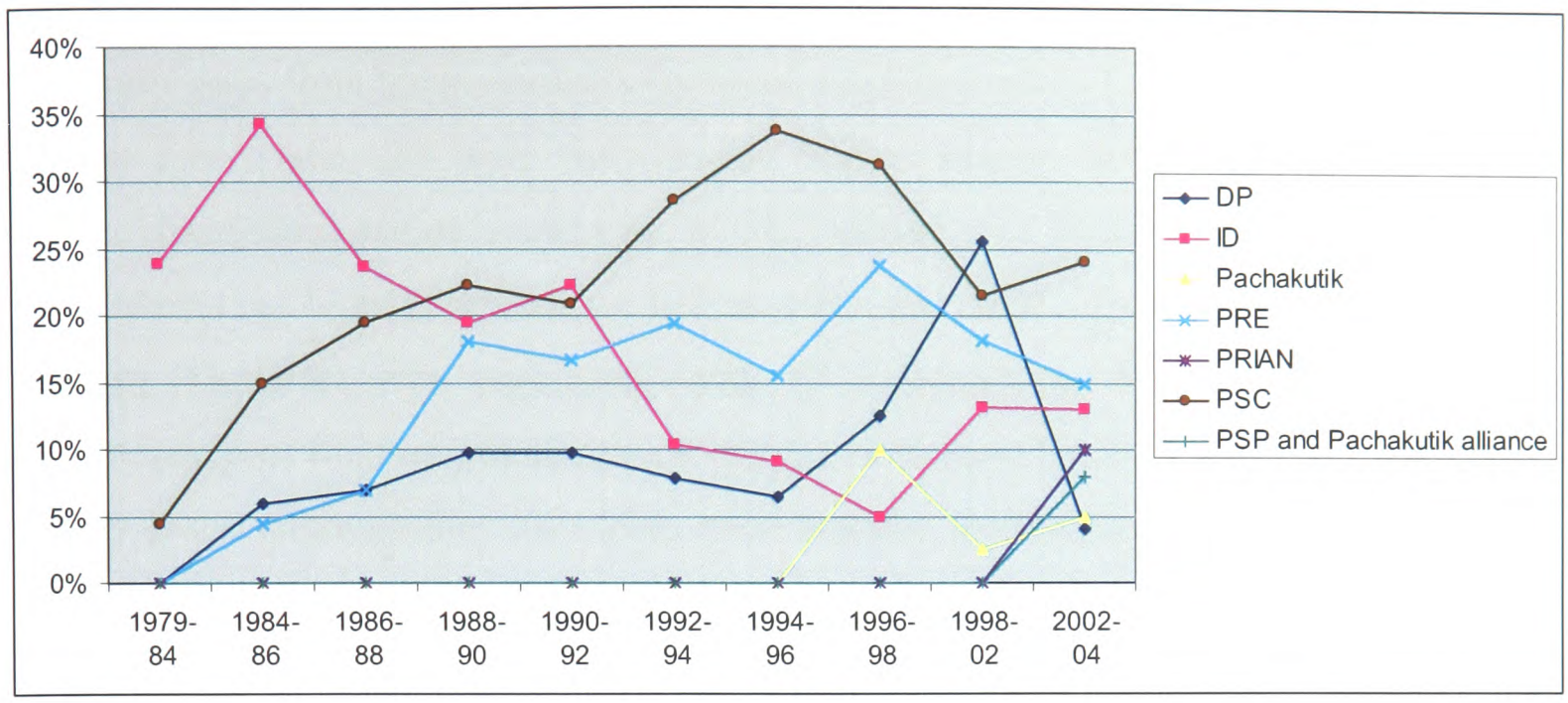
[177] Sartori (1976).
[178] A 2006 IDB study found that Ecuador had 6.71 effective parties after the last two legislative elections (Stein, Tommasi et al. 2006).
[179] They also report that Ecuador's party system is generally seen as one of the most weakly institutionalised in Latin America (2004:24).
[180] Freidenberg (2002b:47)

Partido Sociedad Patriótica 21 de Enero	PSP	2
Joint list of MUPP-NP and PS-FA		2
Joint list of MPD and PS-FA		2
Partido Socialista Ecuatoriano-Frente Amplio	PS-FA	1
Concentración de Fuerzas Populares	CFP	1
Partido Libertad	PL	1
Movimiento Patria Solidaria	MPS	1
Movimiento Integración Provincial	MIP	1
Transformación Democrática	TD	1
Joint list of ID and MIRE		1
Joint list of ID and DP-UDC		1
Joint list of ID and Movimiento Ciudadanos Nuevo País		1
Joint list of MUPP-NP and MCNP		1
Joint list of DP-UDC, PS-FA and Alfarismo Nacional		1
Joint list of PSC and Unión Nacional-UNO		1
Joint list of PSC and AN		1
Joint list of PSP and MPD		1

Source: Supreme Electoral Tribunal (2005), www.tse.gov.ec.

Four major parties (PSC, ID, PRE, DP) have dominated the national legislature, capturing 63% of the seats between 1978 and 1998. Since then they have been joined by three other significant parties: Alvaro Noboa's PR1AN, Gutiérrez' PSP and the indigenous Pachakutik. Figure 5.2 shows the parties of contemporary significance, namely those which have held over 10% of the seats in Congress since 1996, plus the PSP/Pachakutik alliance which fielded a successful Presidential candidate (Gutiérrez) but captured only eight seats. As shown, from 1979-2004 no party held over 35% of seats.

Figure 5.2: Percentage of Congress held by selected political parties, 1979-2004



Source: Supreme Electoral Tribunal (2005), www.tse.gov.ec.

Fragmentation within society translates into fragmentation in Congress for three main reasons. Firstly, Ecuador has a (d'Hondt) proportional representation system and barriers to establishing parties are low. Because *all* parties typically hold less than 25% of seats, and coalitions generally depend on several very small parties to achieve a majority, there is little support for making it more difficult for small parties to survive. When restrictions have been placed, such as the 1978 law which was to disband parties receiving less than 5% of votes in two successive elections, a loophole allowed parties to be immediately reconstituted as new. Variations of this law have been enacted and repealed several times, and even when in force, the 5% law has seldom been applied even to clear violations. Secondly, fragmentation arises from the two-round presidential/congressional election system.[181] There are two rounds for the presidency, the second a run-off between the two most popular candidates from the first round (unless a candidate wins enough votes outright, which has never happened). Members of Congress are elected at the time of the first presidential round. The first round typically sees a proliferation of presidential candidates who divide the electorate and each bring a few legislators along.[182] Thirdly, there are also low barriers to members of Congress abandoning parties. Unlike in some political systems, such as New Zealand, legislators who change parties or

[181] Ironically, this was intended to have the opposite effect, by ensuring incoming Presidents had the backing of established parties (Mejia-Acosta, Araujo et al. 2004: 7).
[182] Freidenberg speculates this might be because voters believe this is not the 'real' election (2003b: 230).

become independent are not forced to seek re-election but remain in Congress for the duration of their original term. Moreover, individual legislators tend to be able to extract more rents from the government by becoming independent *hombres de maletín*, 'briefcase men', who sell their votes to the highest bidder. With this incentive structure, abandoning parties is common. In 1993 alone, 22 of 77 legislators left their parties; almost as high a percentage left in 1997 and 2001. Two years into his presidency, Gutiérrez was negotiating with 17 independents. The high rate of defection increases fragmentation within Congress as independents act autonomously from any party, although they also often band together to form one or more quasi-party bloques.

Incentives to veto

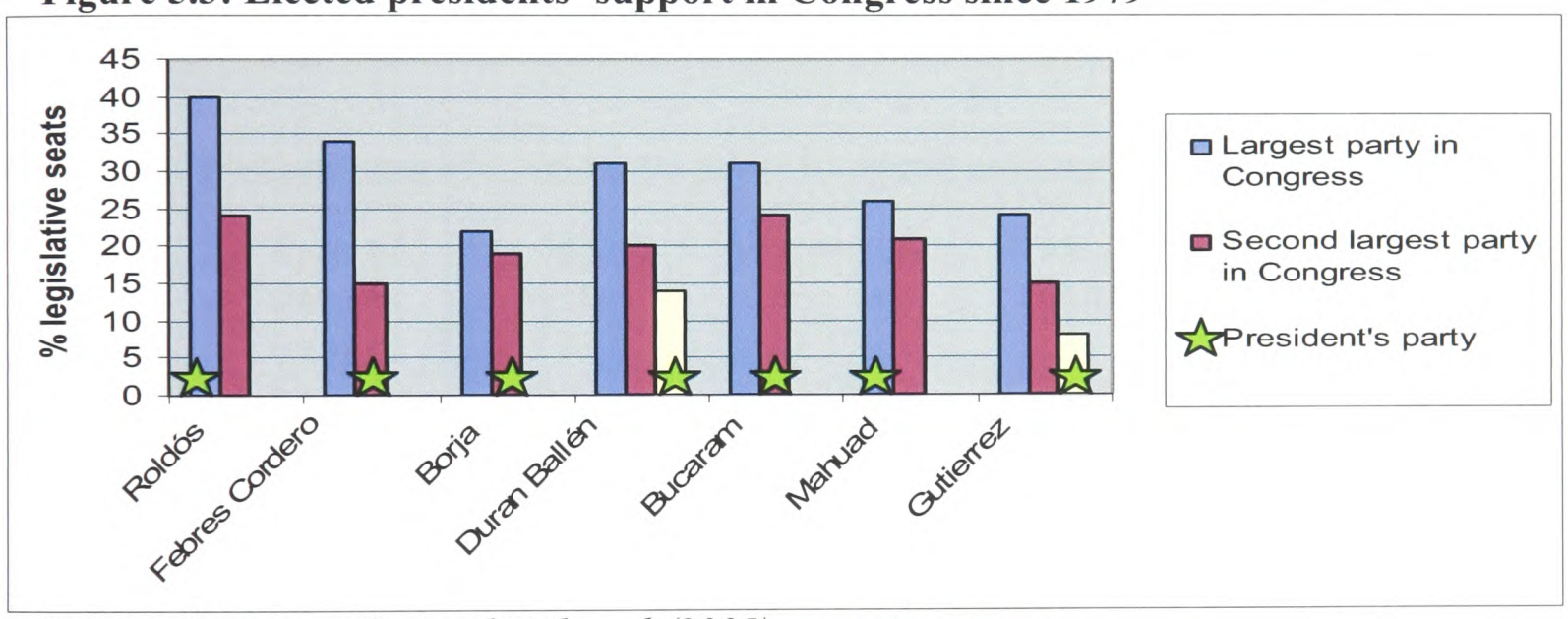
So far, this chapter has shown that society and Congress are fragmented, that the executive has little legislative support, and that this affects veto players both inside and outside the legislature. The second question to answer in this chapter is, why do these fragments remain separate and oppose the executive rather than coagulating or cooperating? Why would players *want* to veto?

There are three reasons, two of which have been demonstrated in the case studies in Chapter Three. The most common of these was rational economic interest—for example, losing lucrative contracts if a state utility is privatised, or losing the individual benefits of a subsidy. A second group of reasons, less common but still significant, are nationalistic or strategic—for example, vetoing a policy as a show of strength to demonstrate and therefore protect political power (indigenous groups and the LPG subsidy, for example). Additionally, there are systemic incentives to oppose the government. These are tightly tied to the systemic instability and the non-programmatic nature of parties described in this chapter so far. Because the first two are more intuitive and have been explored in the cases, here I dwell upon the third, which was ever-present but has not yet been discussed explicitly. In exploring it I concentrate on Congress, with the understanding that instability in Congress also creates opportunities for societal groups without legislative representation.

Underlying the chronic legislative opposition we saw throughout the case studies is a lack of systemic incentive for parties to cooperate with the government, either for rent-based or for ideological reasons. On the contrary, parties benefit from opposing. This is because of the combination of two features of the Ecuadorian

system: the lack of political support for Ecuadorian presidents *ex ante* and thus their weakness,[183] and the way parties are rewarded for attacking presidents when they are weak. Let us consider executive weakness first. As a result of the extreme fragmentation of Congress, since democratisation in 1979, although the president has at times cobbled together a majority coalition in Congress, *no president's party has ever formed a majority in Congress*. In the ten years from 1994-2004, the total time that a president had a majority in Congress was six months (in 1999). In addition, as figure 5.3 shows, of the seven presidents elected from 1979-2004, five were opposed by the single largest party in Congress (and two were opposed by the second largest as well).[184]

Figure 5.3: Elected presidents' support in Congress since 1979



Source: Supreme Electoral Tribunal (2005), www.tse.gov.ec.

In fact, it is more common for the president to have less than a quarter of the seats in Congress. Gutiérrez had only eight PSP coalition members (some of whom, including his own wife, regularly voted against his proposals). Twice since 1996, the president has had no seats whatsoever in Congress (Presidents Noboa and Palacio) and once only 1.2% (Alarcón). This forces the executive to spend considerable time making and sustaining congressional alliances, which tend to be highly unstable. In the Latin American context Ecuador is unusual in having such weak legislative support for the president.[185]

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[183] Several scholars see the Ecuadorian executive as unusually *strong*. Their arguments are considered and rejected at the beginning of the next chapter.

[184] 'Largest' and 'second largest' are significant groups since the constitution provides that the Presidency of the Congress is held by the former for two years, then the latter for two years.

[185] Arteta and Hurtado found that Ecuadorian presidents' parties had the lowest share of seats in Congress out of the 16 Latin American countries in their study (2005:164).

Ecuadorian presidents are thus weak from the beginning of their administration. Moreover, public and congressional support only drops from this point. As we saw in Chapter Four, an Ecuadorian president typically takes office with 50-70% approval ratings, which fall to around 30% within the first four to six months and never recover. Since 1988, the only president to have over 50% support after four months was Mahuad, whose support dropped precipitously soon afterwards.[186] Prior to their abolition in the constitutional reforms of 1998, midterm congressional elections tended to reduce support for the president's party, as table 5.5 shows.[187] Furthermore, presidents' weakness in Congress is mirrored by a lack of control over other constitutional bodies. During Gutiérrez' term, the opposition parties controlled 16 of the 18 legislative committees, the state comptroller, the Supreme Electoral Tribunal and the Constitutional Court.[188] Moreover, as a new force, the Gutiérrez government had no representation at the local government level, unlike the opposition.

Table 5.5: Performance of president's party in midterm congressional elections

Year	Type of election	President's party	Seats held in Congress	Outcome of midterms
1984	General	PSC	12.7%	
1986	*Midterm*	PSC	19.7%	Gain of 56%
1988	General	ID	42.3%	
1990	*Midterm*	ID	19.4%	Loss of 54%
1992	General	PUR	15.6%	
1994	*Midterm*	PUR	3.9%	Loss of 75%

Source: Freidenberg (2003b:237).

The chronic weakness of the Ecuadorian president is the first element. To this is added a system in which parties benefit from attacking an unpopular leader and suffer from association with one. By opposing a weak leader, parties appear more in line with popular opinion. Media attention is scarce in a crowded political arena, so there is an incentive for parties to be vicious in opposing government policies in order to capture attention. While in other countries, party members' ideologies might constrain this process, in most major Ecuadorian parties there is no such internal constraint. In New Zealand's similar proportional representation system, for example,

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[186] No opinion poll information is available for interim President Alarcón.
[187] Since 1998, falling public support has not directly affected the makeup of Congress. However, sectional government elections still occur and fulfil basically the same function.
[188] *Oxford Analytica* (2003).

it is inconceivable that the Green Party would support libertarian ACT. Individual members would revolt. In Ecuador there are *no* inconceivable coalitions, and numerous examples of accommodations between self-titled 'right-wing' and 'socialist' parties.

Presidential weakness also provides an opportunity for parties to gain rent by opposing the executive. Ecuadorian parties respond to two imperatives which must constantly be balanced: they must extract as many rents as possible from the state, but also maintain and increase their order in Congress by controlling as many electoral posts as possible, at sectional and national level. They must therefore maintain mass appeal while in fact serving a narrow group of 'owners'. Instead of promoting a particular ideology, then, parties decide whether to support a policy by calculating the rent they gain directly versus the impact on their political space (their political 'brand'). During budget-setting, for example, parties typically make their support conditional on rents from the central government which they then redistribute throughout their networks to gain political space and solidify power.[189] The price depends on the policy's impact on a party's 'brand', which determines its ability to extract rents over the long term. Parties measure the short term rent they can extract from the government for a given policy against its effect (positive or negative) on the patronage network that sustains the party. Where an executive is unable or unwilling to pay rents to achieve congressional support, the measure fails. Where the rent to be paid is sufficient, a short-term coalition in support of the President will form. Since the government is chronically unpopular, parties often argue that their political capital will diminish simply by virtue of being associated with the government, and that they therefore need to be compensated for this.[190] Even where the policy in question would *benefit* the party's clients, some rent can still be extracted to compensate for the damage to the 'brand' from being seen to support the government.[191]

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[189] The PSC was most frequently mentioned regarding this practice. Interviews, former members of executive and legislature, Quito 2005.

[190] Interviews, former members of executive and legislature, Quito 2005.

[191] A common solution is for party members to be absent from Congress. This can help the government gain a majority, or force a quorum count and therefore allow emergency legislation to pass into law under the 30-day rule. It allows a party to support the government and gain rents while not explicitly voting with the government. Mejia-Acosta, Araujo et al. (2004: 53) call these 'ghost coalitions', noting that such arrangements are often "disguised under a cloud of heavy criticism against the president with the purpose of projecting an image of political chastity or government independence vis-à-vis other parties and potential voters". Noboa's VAT increase passed Congress in this way (see Chapter Three).

Since 'flip-flopping' is not punished internally or electorally, the incentives to oppose the government often outweigh the costs. Parties' default position is thus to oppose the executive, *even if these parties would promote those same reforms if they held the presidency*. Arteta and Hurtado find that the PSC's actions are "one of the clearest and most consistent examples" of this, having successfully opposed tax increases since 1988, despite raising taxes under the last PSC presidency.[192] Indeed, the president who enacted the most reforms in the last 15 years, Durán Ballén, named the PSC as the biggest obstacle to his reforms even though he subscribed to the same ideology which the PSC claimed—and had co-founded the PSC.[193] Rather than supporting Durán Ballén's neoliberal reforms, the 'free-market' PSC were Durán Ballén's "worst enemies". As then Secretary of State Carlos Larreátegui said, "Not even the extreme left was as harsh in its opposition as the PSC."[194] Arteta and Hurtado add that "all parties are guilty of this double standard."[195] The Mayor of Quito, an ID member, was vehemently opposed to privatising Quito's electricity distribution company, vetoing it 'on principle' and attempting to impeach Energy Minister Pablo Terán—and then leading the privatisation of Quito's airport.[196]

Tools of opposition

We have now seen that society and Congress are politically fragmented, and that there are reasons for these fractions to oppose the executive both inside and outside Congress. The next question (this chapter's third) is, how is each fragment able to turn this opposition into a *veto*? Chapter Four revealed several tools of veto, some exercised through the legislature, some outside the legislature. It showed that players do not need legislative representation to have a veto, just the ability to credibly threaten. We saw that a variety of tools were used to credibly threaten

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[192] Arteta and Hurtado (2005:165).

[193] Interview, Sixto Durán Ballén, 4 April 2005, 4pm, Quito: "I left in 1990 because they'd abandoned their principles, had become just political, Machiavellian...I stood for a party of freedom of investment, freedom of work, not having everything in the hands of the government but in the hands of the individual. But the PSC at the time just wanted to oppose [former President] Borja on everything, whether he was right or wrong. And I didn't agree with that so I resigned."

[194] Interview, 4 April 2005, 4pm, Quito.

[195] Namely, "while in office, parties succumb to the need for implementing tough and unpopular policies.....but when they are out of office, political party leaders adamantly oppose these same policies" (Arteta and Hurtado 2005: 165).

[196] In fact, a delegation from the ID approached Terán just days after their attempt to impeach him, to ask his advice on how to politically manage the airport privatisation. Interview, Pablo Terán, Minister of Energy, 22 March 2005, 11am, Quito: ""They wanted to copy the process of the OCP which they impeached me for! They said 'Pablo, give us some ideas, because we want to do the same thing with the airport.' Incredible!"

decision-makers in the seven cases of failed reform: formal vetoes in the legislature and Constitutional Tribunal (and the threat thereof), strikes on essential services, the threat of overthrow through mass mobilisations, and the threat of withdrawing legislative support for an administration. Several groups had multiple tools. Even as indigenous groups took official political form as Pachakutik, they continued the non-traditional forms of protest they had developed during the 1990s; road blockades, occupations of universities and churches, frequent strikes and protests, and attacks on state infrastructure, especially Amazonian oil extraction and transportation equipment. When Pachakutik's congressional presence, which has always been small, has been insufficient to achieve favourable policy outcomes, the indigenous movement has been able to use other means of protest, often successfully. Chapter Five added a sixth tool of opposition, the threat of judicial veto on individual reformers.

Although all these tools are important in understanding policy stasis, the judicial veto is particularly significant and merits some more explanation. In Chapter Four, we saw how the judicial system was used offensively against reformers, beginning with the exile of former Vice-President Alberto Dahik, which opened the door for later quasi-legal oustings of Presidents. We saw that veto players gained in number and strength as the precedents mounted. However, this is only half the story.

As a series of reports and scandals have shown, the Ecuadorian judiciary is politicised, unprofessional and unreliable. A 2006 IDB study found Ecuador's judicial independence was among the lowest in Latin America (scoring 1.9 on a scale from 0 to 7; 7 being completely independent).[197] A US State Department report was damning: "The Ecuadorian judicial system is plagued by processing delays, questionable and unpredictable judgments in civil and commercial cases, inconsistent rulings, limited access to the courts, and impunity, particularly in corruption cases".[198] When the LatinoBarometer 2004 asked 'what possibilities are there to bribe a judge', 47% of Ecuadorians answered that there were 'many' possibilities—the third highest percentage in Latin America. *The Wall Street Journal* reported that a 1999 international survey of investors rated Ecuador one of the world's worst for 'rule of law'.[199] In 2005 it was discovered that some Supreme Court judges received their doctorates in jurisprudence through 'diploma mills' just days before their

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[197] Stein, Tommasi *et al.* (2006).
[198] US Department of State (2005).
[199] Heritage Foundation (2001:155).

appointments. One degree was annulled after investigation.[200] Arteta and Hurtado note, "The political and economic network of special interests also operates in the judicial system by obstructing sentences, nominating judges, bribes and other means. The pressure of influential participants often distorts legal rulings".[201] Public confidence in the judiciary is extremely low, and falling.[202] The judicial system has become a nakedly political tool of the status quo, and parties battle to control it. Traditionally, courts have been controlled by the PSC, ID and DP, with the PSC having most influence, especially over penal judges;[203] in 2004, the PSP, PRE and PRIAN wrested control.[204]

As well as *offensive* use against reformers like Dahik, charges are also used *defensively* to protect those who engage in clientelist, rent-seeking activities. Principally, this occurs via Preventative Prison Orders (PPOs), court orders which in other jurisdictions are issued as a last resort before a trial begins, to prevent high-risk criminals committing crimes.[205] In Ecuador, PPOs have become a staple measure which the Ecuadorian judiciary can deploy to protect those who support their tenure. Typically, the courts will simultaneously pursue genuine cases of corruption and also frivolous cases designed to threaten, punish, and draw time and attention away from the genuine cases which would hurt a powerful interest group.[206]

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[200] *El Comercio* (2005).

[201] Arteta and Hurtado (2005).

[202] The LatinoBarometer showed a 20% drop in the population who trusted the judiciary between 1996 and 2002. In 2002 almost 85% said they had little or no faith in judicial power.

[203] See for example Larrea (2004).

[204] In December 2004, the politicisation of the Supreme Court peaked when Gutiérrez' new alliance in Congress (PSP, PRE and PRIAN) replaced the existing Supreme Court with one favouring them, sparking mass protest. It had become obvious that control of the penal judges was standing in the way of PRE's access to state resources, since the exiled PRE leader Bucaram's return to Ecuador would raise the party's standing dramatically. PRE therefore entered a coalition with the PSP. In return for support in an impeachment proceeding in December 2005, a PSP/PRE led coalition dismissed the (PSC-controlled) Supreme Court and installed PRE appointments who cancelled Bucaram's criminal charges and brought him back to Ecuador. International observers—including Amnesty International, Human Rights Watch and the United Nations—protested, but were powerless (see, for example, Green 2003).

[205] The 1998 Constitution of Ecuador, article 24(8), provides that Ecuadorians may be detained preventatively for up to a year. However, even by 1997 an Organization of American States report noted that the failure to maintain reasonable limits on this process was becoming a "critical problem", and that individuals were being held for up to six years without being a judicial determination of the accusation against them (OAS 1997).

[206] A US State Department report claimed the practice was also used against foreign nationals for business reasons: "Criminal complaints and arrest warrants against foreign company officials are used to pressure companies involved in commercial disputes... Ecuadorians involved in business disputes can sometimes arrange for their opponents, including foreigners, to be jailed pending resolution of the dispute" (US Department of State 2005).

An example illustrates the process. In the 1990s as part of the exposure of many cases of banking fraud, the Central Bank initiated law suits against the owners of Banco Continental—the powerful, well-connected Ortega family of Guayaquil—in Miami, the Bahamas and Ecuador.[207] In response, a counter-case was brought against the Central Bank and the matter was therefore moved to the Supreme Court.[208] The President of the Supreme Court issued PPOs against nearly everyone involved: Continental's directors and owners, the central bankers, the Monetary Board, and the Superintendent of Banks.[209] One central banker who was issued a PPO called this a 'clever strategy of obfuscation', forcing all parties to leave Ecuador under the same fog of suspicion and increasing the incentives for the central bank to drop the original case.[210] This was an early example of a trend which has increased since the late 1990s: a case is elevated from a lower court to the more-politicised Supreme Court, and PPOs are issued against both sides, making it impossible to tell who is guilty and who innocent and creating a shared interest in dropping the issue altogether. Typically, those under PPOs flee the country to avoid prison, and the case is never brought. For the guilty, flight has often been expected and funds have been secreted away in preparation. However, for public officials or private citizens issued PPOs unexpectedly, this can be devastating. Worse, the constant threat and example of PPOs has created a situation in which very few technocrats will take risks in public policy, especially promoting reforms which harm the interests of powerful families and clientelist networks. Meanwhile, the popular reputation of the Supreme Court actually benefits from this practice of scatter-gun PPOs, as the public perceives that something is being done to combat corruption; there is rarely or never sufficient familiarity with the details to realise that actually the opposite has occurred.

This use of PPOs maintains the unreformed status quo in the short and the long term. In the short term, PPOs remove reformers and protect corrupt forces. As well as Dahik, many high officials, including several ex-ministers of finance, fled Ecuador under PPOs rather than risk pleading their case in rigged courts. In addition, there are around 50 other high ranking economic officials who were issued PPOs

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[207] Freer (2001).
[208] The Central Bank, via its PR firm (Conover) issued a press release accusing the Ortegas of a "massive fraud scheme." The Ortegas then sued the Central Bank for defamation. The Central Bank pleaded truth as a defence (King 2000).
[209] Larrea (2004).
[210] Interview, Augusto de la Torre, General Manager of Central Bank (1993-1996), 16 September 2005, 10am, Washington.

following the 1999 banking crisis. At one point there were PPOs against the entire Board of the Central Bank, the GM of the Central Bank, the Superintendent of Banks, and the heads of most of the major private banks.[211] In addition to the last five presidents, who were *all* either exiled or jailed, other high public officials forced to leave Ecuador have included: Minister of Economy Jorge Gallardo; Deposit Guarantee Agency head Wilma Salgado; General Manager of the Central Bank Augusto de la Torre; Minister of Economy Ana Lucia Armijos; Minister of Economy Carlos Julio Emanuel; Superintendent of Banks Juan Falconi; President of Central Bank Luis Jácome; and many more.[212] Numerous private bankers were also forced into exile.[213]

In the long term, the phenomenon deters reform efforts. Would-be reformers are aware that their predecessors were jailed or exiled. They see powerful reformers targeted even after the reform is cancelled. In a postscript to Chapter Three's telecommunications case, Ricardo Noboa, head of Conam and the former President's brother, was jailed after alleging corruption in the failed sale of Pacifictel. Noboa announced in a television broadcast on 30 May, 2002 that the Pacifictel process had been cancelled, using "strong terms" to people he said had campaigned to prevent Pacifictel's privatisation.[214] PSC congressman José Alvear Icaza, to whom Noboa had referred as the attorney for two companies with interests in the telephone sector (Cybertec and Alcatel), accused him of defamation. On 5 March, 2003, the Second Court for Criminal Matters of Pichincha found Noboa was guilty of serious non-calumnious defamation and sent him to prison.

Of course, it is difficult to distinguish the genuine from the retaliatory cases. Here I make a more narrow claim: that cases such as Dahik's and Noboa's are well-known among elite civil servants and are taken as a warning to would-be reformers. One high official I interviewed travelled to work every day with his passport and $4000 cash in case he had to catch a hasty plane to Miami. Others told me how paralysed they felt by the constant threat and example of criminal charges against

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[211] See, *inter alia*: Moss (2000), *Hoy* (1999), Commission for Civil Control of Corruption (2002), *Hoy* (2002d), *Spanish Newswire Services* (2000a).
[212] Pyper (2003), Castillo (2006), EFECOM (2001).
[213] These include directors, major shareholders or managers of Banco La Previsora (Alvaro Guerrero), Banco del Progreso (Fernando Aspiazu), Banco Continental (Leonidas Ortega), Filanbanco (William Isaías Dassum and Roberto Isaías Dassum), Banco del Pacífico (Arturo Quiroz), Banco Popular (Nicolás Landes), Ecuacambios (Soliman El Aasser), Banco del Azuay (Carlos Julio Miranda Alcívar and José Miranda Alcívar), and Banco de Préstamos (Alejandro Peñafiel).
[214] OAS (2005).

colleagues, and how large the disincentive to make enemies by changing policy and disrupting corrupt networks. Many lamented the number of bright young economists who choose to work abroad rather than be swallowed by the political system. One official who had arrived at a high position on merit—modestly, he told me everyone more qualified had emigrated or been forced into exile—described in detail how he had had to enter political deals and even to abet grand corruption or face career ruin, and how he advised his children not to work in Ecuador.

Credible threats

The concept of a *credible threat* is central to a veto. The final question for this chapter is, what makes these tools of opposition sufficiently credible and threatening to warrant their designation as a veto? Vetoes are path-dependent; they are created and sustained by an earlier analogous demonstration of a veto player's ability to overthrow an individual or group. In the case of the judicial veto, the well-known history of successfully targeted individuals makes the threats credible. In the case of mass protest or strikes on strategic services, the history of successfully targeted governments makes the threats credible. For reforms committed to by the executive as a whole (such as—in theory, at least—IMF programmes), the credibility of several of these tools is intimately tied to the chronic extreme instability of the executive. Here I outline this link.

It could be said that the only constant in Ecuador is instability: from independence (1830) to democratisation (1979) the average government lasted less than two years. Today's governments, as we have seen, are no more secure. From 1996 to 2005 Ecuador had five presidents in nine years—an average tenure of 1.8 years (the full term is four years). Earlier in this chapter, we noted that no president's party has ever formed a majority in Congress (figure 5.3), that presidents' support drops halfway through a term (table 5.6), and that support is relatively low for Latin America (table 5.5). As the cases in Chapters Three and Four showed, congressional coalitions are temporary and highly volatile. As Chapter Four showed, the president's 'honeymoon' is short and some presidents never have one. All of this creates a culture of instability wherein a given government is, or *appears to be*, almost permanently on the verge of falling. A rumoured coup, impeachment or flight to exile can be enough to galvanise opposition to government proposals of all kinds. If the government looks likely to fall, opposition parties do not wish to be tainted by association and will

instead vocally oppose even technical policies which they agree with in principle. Alternatively, they will demand a high price for their political support. If the catalyst is dramatic, such as the economic crisis in 1999-2000, it can spark a complete withdrawal of political support and the government falls.

The judicial veto has contributed much to this instability. But chronic instability is now so established that other groups can also take advantage of it. As groups learned they can bring down policies and leaders, chronic instability was embedded ever more deeply and the number of players who can credibly threaten grew. In 1996, Ecuadorians learned that popular protest could overthrow a president, if the legislature was amenable. In 2000, the indigenous group Conaie, backed by the armed forces, managed to oust Jamil Mahuad, proving themselves a credible veto player. As presidents arrived in office backed by ever smaller power bases, it became increasingly obvious that leaders' grip on power was tenuous. The critical level of public protest needed to oust a president dropped. By 2005, Gutiérrez was removed after just five days of peaceful protest, mostly confined to Quito.

In other words, from the mid-1990s onwards, the phenomenon of executive instability became a vicious cycle. Veto attempts were both *cause* and *consequence* of executive instability. The cycle worked this way: each government has low congressional and public support and appears vulnerable to attack, causing a loss of confidence in the executive. Then, even though midterm elections no longer exist, parties are still aware that their brand suffers from association with an unpopular president, and political actors outside Congress such as unions are aware of the vulnerability of the president in the second half of his term. They can take advantage of their stronger bargaining position vis-à-vis the president to extract particularly large rents. For an Ecuadorian government to have any chance of surviving its term, it must reverse policies and is unlikely to be able to enact new reforms. This results in halfway reforms followed by rollbacks.[215] The losses of power and credibility by the government reinforce themselves, as increasingly-vulnerable politicians undertake

[215] An example of this was an oil reform attempted under Gutiérrez which aimed to permit private participation in disused Petroecuador wells. The reform looked likely to be approved until the three articles were presented in Congress at the same time as an impeachment rumour surfaced. The reforms failed to pass Congress, even though earlier the government had received support for the law from the large parties in Congress. It seems highly likely that the reforms were rejected for party political reasons. As then Minister of Government, Raul Baca, said: "The PSC was in complete agreement with us when the law was discussed in the commission... but then the threat of the impeachment came and the response was, at the end, political. Not technical." Interview, 6 April 2005, 9am.

desperate measures in the short term, some of which increase opposition in the medium term.[216] Parties do not wish to be associated with a government in freefall, and they withdraw their support, often following a minor scandal or other incident. The fear that the government might fall becomes self-fulfilling as a result of this political capital flight. As the office of president became more unstable, presidents became more vulnerable to vetoes on policy grounds and more likely to cave in to demands that they halt reforms which would damage powerful groups, when politically vulnerable (i.e., virtually all the time).

In consolidated democracies, neutral players would play a restraining role in this process. But Ecuador's judiciary at the highest levels serve at the pleasure of political leaders and either ratify the decisions of those on the political ascendant[217] or fall with those out of favour.[218] For its part, the army has demonstrated a preference for keeping the greater peace by facilitating a quick exit by outgoing presidents, enforcing the express will of Congress or the judiciary against the president if backed by a popular majority (even when quasi-legal). Then, after each president fell, he has been replaced by an interim president. These interim presidents have no party support whatsoever, meaning their position is just as precarious as the presidents they replaced.

The final piece of the puzzle is veto asymmetry. While any veto player can bring down a government or send a President into exile—and have done so five times since 1996—the reverse is not true. That is, no veto player can *sustain* a government in the face of opposition from another veto player. No single political power—inside or outside Congress—can impose its own agenda, and no political party can govern by itself. The largest party, the PSC, has had tight control over the courts which has allowed them to manage criminal charges. By exercising this power or credibly threatening to do so, they can veto policy. However, the PSC has been unable to use this power in a positive policy sense; that is, despite consistently being the largest party in Congress, the PSC has been unable to field a successful Presidential candidate.[219] The PSC is thus unable to capture the administration itself, and can only

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[216] The last six months of the Gutiérrez administration are a prime example of this. Lacking congressional support before an impeachment vote, in desperation Gutiérrez was forced to make a deal with PRE, conceding Abdalá Bucaram's return from Panama. This enraged the other parties. Then the PRE inevitably deserted Gutiérrez once Bucaram was safely back in Ecuador, eventually leading to Gutiérrez' downfall.

[217] As occurred with the transitions following the PSC's enemy Bucaram in 1996.

[218] Such was the fate of Gutiérrez' Supreme Court in 2004.

[219] The last PSC President was Leon Febres Cordero in 1984.

veto and threaten vetoes in order to affect policy. It is not alone in this. As figure 5.2 showed, *no party has been able to win more than 35% of seats* in Congress at any time since democratisation. The PSC is the largest party, but even it has usually held less than a quarter of Congress. Other major parties spiked in a particular election then fell precipitously as the electorate became disillusioned with them; figure 5.2 shows this occurring with the ID in 1984, PRE and (to a lesser degree) Pachakutik in 1996 and, most dramatically, the DP, which was blamed for the economic crisis in 1998. Even these spikes rarely propel parties above 25%. A clear illustration of the inability to use political power in a positive sense is the failure of the major parties in Congress to capture the Presidency, despite strenuous campaigning efforts and credible candidates. In the 25 years since democratisation, *only one party has ever held the Presidency twice* (DP), and the two administrations were almost 15 years apart.

The result is policy stasis. As we saw in Chapter Three, policies can be struck down by a wide range of players. A reform which affects a rent-seeking group can be vetoed by that group with little opposition from other groups, even if they would benefit by a smaller amount. In some cases, while all agree that the status quo is undesirable, a key player vetoes each reform option and the status quo continues. For example, the decline of Petroecuador is lamented by management, unions, politicians, the IMF and MEF alike. But one group believe the solution to Petroecuador is to strengthen it within the state apparatus, and another, to privatise it. Neither group has sufficient force to impose its agenda, but both can veto. Petroecuador continues to decline. Similarly, a reform increasing the power of Guayaquil will be vetoed by Quito, and vice versa. The status quo is perpetuated by a proliferation of veto players.

Conclusion

In 1996, Ecuador entered a period of extreme political instability from which it has never emerged. Instability has become normalised in the political consciousness. No government has had a strong hold on power and, consequently, the number of veto players has been rising. The lack of accountability or effective representation of constituencies results in a populace severely disillusioned with electoral politics and encourages their recourse to clientelism. It becomes dangerous to lack political protection, especially in high office, and many officials who are not incorporated into the system or whose network has fallen from grace have found themselves expelled from Ecuador altogether. The longer instability continues, and the more that

administrative turnover accelerates, the less confidence Ecuadorians will have in an anonymous state. Lacking confidence in the state apparatus, it becomes increasingly rational to have recourse to patronage networks for protection; a vicious cycle. Entrenched rent-seeking interests draw their power from patronage networks, and these networks themselves are self-sustaining and tend to deepen rather than weaken over time.

This chapter has attempted to explain why veto players in Ecuador can and do block reform. It sought to understand how and why legislative and societal veto players proliferate, and from where they draw their power. Its investigation was framed by four sub-propositions: that Ecuador has many players (1) who want to veto (2), each of whom has a method of threatening (3) which is credible (4). The investigation has shown that Ecuador's political power is extremely fragmented, with each faction possessing strong incentives to oppose the government. Veto players outside the legislature feed off the instability caused by fragmentation inside Congress. Parties are generally not programmatic and lack a clear ideology, mostly working for political power to feed their patronage networks. Desiring power rather than policy, they have little incentive to work with the government except where rewarded in ways immediately transferable to their clients. Legislative opposition becomes entrenched; then, because of the politicisation of the Ecuadorian courts, this spreads to the judiciary which becomes merely another arena for political battle. A vicious cycle has made threats from such players credible. In this chapter we saw that veto players can veto at every level, and that they cannot advance a positive agenda, only veto.

These findings shed light on why the impact of crisis on reform in Ecuador has not been as positive as the literature might suggest.[220] If crisis increases instability, and reform stasis is consequent upon instability, then it follows that crisis exacerbates stasis rather than catalysing reform in the long term. Crisis has been instrumental in creating the underlying conditions for veto players to proliferate by increasing instability, allowing more groups to credibly threaten the government. In the most dramatic example, Mahuad's fall during the 1999-2000 economic crisis marked the indigenous groups' maturity as a veto player. Ecuador has certainly become trapped in

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[220] A second implication worth noting is theoretical; the case is consistent with Tsebelis' prediction that significant departures from the status quo are impossible when the winset is small (2002:2). The winset is small because veto players are many, and tend to have a zero-sum attitude to policymaking (since their major aim is not ideological but based on increasing their own relative power).

a poor political equilibrium, but the evidence suggests that crisis would not disrupt this equilibrium in a helpful way.

This chapter has linked Ecuador's failure to reform to a proliferation of veto players. However, it is also important to examine the other side of the coin: the inability of the executive to deal with the veto players. Where this chapter has focussed on the legislature and society, the next chapter focuses on the executive, accounting for variance in executive capacity and the ability to manage reform in an environment in which veto players proliferate.

Chapter Six: Executive Incapacity to Cope with Veto Players

It is often noted that Ecuadorian executives have substantial powers.[221] Since 1983, the president has been able to fast-track economic laws, meaning they become law by default if Congress does not decline them within 30 days.[222] For all legislation, the president has a line veto. Once vetoed, for the Congress to reinstate its original position it must have a two-thirds supermajority and vote within 30 days, meaning the president only needs the support of one third of Congress. After a package veto, the Congress may not consider the bill again for a year. The president also has substantial powers of decree, exclusive powers to initiate budgetary proposals, and can use off-budget discretionary accounts, grant judiciary pardons, and appoint and remove ministers and some governors at will. The president directly controls a large proportion of the Ecuadorian economy—about 30%, depending on the way it is measured. The Solidarity Fund alone manages over $3.6 billion in assets, controlled directly by the president. Although Congress passes the budget, the executive controls its execution, with few reporting requirements.

However, as we have seen, the executive is particularly *weak* when it comes to its own survival. Ecuador's executive may have extensive powers in theory, but it cannot use them if it is overthrown, and cannot use them with impunity if it is credibly threatened with overthrow. Additionally, as we will see, in practice some of the above provisions are irrelevant and others are simply ignored. This affects the state institutions managed by the executive, and so 'executive incapacity' quickly becomes 'state incapacity'.

The institutional literature in Chapter One revealed that executive incapacity had been found elsewhere to impede reform, and Chapters Three and Four established that this was the case in Ecuador too. Those chapters also found that reform was impeded by two other factors, legislative opposition and societal veto players, whose roots were examined in Chapter Five. This chapter therefore completes the investigation of the three factors impeding reform by focussing on executive

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[221] In Shugart and Carey (1992), Ecuador's president was one of the most powerful in terms of legislative powers. Shugart and Carey found the Ecuadorian president was only 'intermediate' in terms of non-legislative powers, but this was because Congress could remove ministers at the time of their research. This is no longer the case. See also Hallerberg and Marier (2004) and Mejia-Acosta, Araujo *et al.* (2004). Several interviewees also made the observation.

[222] Until 1998, the period was two weeks.

incapacity. In part, 'executive incapacity' is the flip side of veto power—the inability of executives to deal with veto players—but it also has its own direct effect on reform. This chapter considers executive incapacity as cause and consequence of the system of patronage networks and the proliferation of veto players, showing how this impedes reform in several ways. As in Chapter Five, I consider the impact of 'instability' on these processes. I then examine two recent trends which are reactions to the system but also serve to exacerbate executive incapacity: 'interim' presidencies and inexperienced 'outsider' candidates. Finally, I show why efforts to reform 'underlying' democratic processes have failed.

Governing Ecuador is enough to challenge even the most capable executive. The Ecuadorian political landscape is complex and multilayered. As we saw, Congress is fragmented and by default opposed to the executive. "Making policy coalitions with multiple actors, who pursue conflicting ambitions and act within short-term horizons, requires exceptional bargaining skills," say Mejia-Acosta, Araujo *et al.* who compare it to "herding cats".[223] It is even worse outside Congress. By their nature, patronage networks are shadowy, and concrete information on their membership and activities is hard to obtain. If this is frustrating for a researcher, it is even more so for policy-makers.[224] The existence of hidden veto players confounds rational and technocratic decision making, especially by foreigners unfamiliar with the system or players. Representatives of the multilateral development agencies expressed frustration with the backroom politics, which several said was worse in Ecuador than other countries they'd worked in (including others in Latin America).[225] Much of the patronage networks' strength arises from off-budget, quasi-legal or stolen funds, overvalued contracts and blatantly politicised appointments. Secrecy is key.[226] Even the IMF has major problems extracting reliable figures and has on some recent

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[223] Mejía-Acosta, Araujo et al. (2004:46).

[224] Ecuador fits Tanzi's comment: "In some countries it would be difficult to understand why certain policies are enacted unless one understood the private economic interests of the wives, children or other close relatives or friends of presidents, prime ministers or top ministers" (2000:447).

[225] One IMF official said, "I was really involved in trying to figure out the inter-agency transfers, earmarking, and subsidies. It took me several months to understand what was going on, where the transfers were going. We were learning together with the authorities! We were working like dogs to understand together where the petroleum grant was going, where the money from the budget was going." Interview, Washington, September 2005.

[226] This is helped immeasurably by Ecuador's public records and accounts, which are opaque, confusing, contradictory, partial, and reflexively protected from researchers' gaze. Much basic data goes unpublished, and much that is meant to be published is difficult or impossible to access, often because systems are not maintained. Official websites, for example, seem to be down more often than they are up. There is no detailed breakdown of how the government budget was executed.

occasions had to give up searching for the whereabouts of several hundred million dollars.[227]

Ecuadorian technocrats are not necessarily much better informed. Some high Ecuadorian officials only found out what was happening and why their counterparts were making certain decisions long after the event. For example, the President of the Central Bank during the crisis, Luis Jácome, expressed his frustration with being unaware of the political obligations of some of his Board until a campaign contribution scandal broke long after he had left the role.[228] In a related issue, it only emerged long after President Mahuad's departure that Mahuad had been politically beholden to a powerful banker, Fernando Aspiazu, and that this undoubtedly explained Aspiazu's blatantly favourable treatment during the banking crisis, including permission to close his own bank with full access to critical information (allowing him time to change or destroy it).[229] Time and again, as we saw in Chapter Three, hidden veto players blocked reforms that ran counter to their interests.

Ecuador's executives have lacked capacity to meet these challenges, and this incapacity has impeded reform. Some key features of the Ecuadorian political system were described in Chapter Five: clientelism, chronic instability, and veto players (as cause and consequence). These features of the system combine to debilitate the executive in three steps. Each step has an independent impact on the executive, and also facilitates the next step.

The first and fundamental step is the vicious circle of incapable executives which cannot deal with veto players, allowing credible threats to multiply. In turn, veto players decrease executive capacity by making it difficult and even dangerous to be an effective high-level public servant. Capable and highly-educated Ecuadorians are dissuaded from working in the public sector and choose to work in the private

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[227] The IMF never managed to track down hundreds of millions of dollars during the tenure of Minister of Economy Emanuel in 2002. This is in addition to the several hundred million dollars missing from the oil sector which was noted earlier.

[228] Interview, 16 September 2005, 4pm, Washington: "The owner of Banco del Progreso was a very influential person, Aspiazu. We learned a lot of things *ex post* we didn't know. For example, one member of the [Central Bank] Board was named by Aspiazu....Aspiazu was very powerful. He owned a newspaper, a television network. He knew he was very powerful. He never talked with me... He always called the Presidential Palace and they would call me, 'OK, what is happening with Progreso?'... We thought this was really strange. ... Obviously, almost one year later we learned that he was the main contributor to the Mahuad campaign. We were already in Washington by that stage. It's incredible to find these things out."

[229] Luis Jácome, former President of the Central Bank, commented: "This was such a preferential treatment or a great favor to the banker that we could not understand at that moment why. Later it became clear." Email received September 16, 2005.

sector instead. As societal veto players gained in number and strength as a result of Dahik's fall, executive capacity began to decrease. With each president, minister or other high official exiled, many fleeing fabricated criminal charges, the risk associated with high public office began to rise. In both 2002 and 2005, Ecuador had more claims to the Inter-American Commission on Human Rights ruled admissible than any other country, most involving the judiciary. Exiled in Costa Rica, Dahik himself judged the probability of facing criminal charges following high office as "almost 100%". The lesson seems to have been learned, as in 2005 President Palacio found his offers of ministerial positions repeatedly declined. With the executive weakened because of the threat of individual veto, the executive makes more mistakes, it becomes easier to veto reforms and thus more veto players are created. Thus the proliferation of veto players is both a cause and a consequence of executive incapacity.

The second step involves political appointments. Rather than selecting those administrators or businesspeople who understand the sector best, posts are often allocated for political and clientelist reasons. Only a few positions need congressional approval; the majority are appointed by the executive directly, making the executive directly accountable to its political constituencies.[230] Executives which are already vulnerable because of the factors above must make political appointments. These then deplete the state at each of three levels. At the executive level, fragmentation along patronage lines reduces the pool of talent available for key state positions. Few presidents are willing or able, as Durán Ballén was, to incorporate rival talent into a cabinet (see Chapter Four). At managerial levels, individuals can drain resources, either illegally or via quasi-legal contractual practices. Appointees are often placed specifically so that they can extract state resources.[231] Then, political appointments in the rank-and-file bloat state enterprises by filling them with unqualified workers.[232] At all levels, it can be difficult for individuals to remain neutral, or even for leaders to change the system. If leaders do not appoint loyal clients to strategic state positions, those already in place who are loyal to other patronage networks may undermine them. For this reason, even those who run on anti-corruption platforms, like Gutiérrez,

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[230] Those needing congressional approval include the comptroller-general, attorney-general, superintendents of banks and companies, and several high judicial posts.

[231] Interviews, high officials, Quito, March-April 2005.

[232] Interview, Pablo Terán, Minister of Energy, 22 March 2005, 11am, Quito: "In my opinion the quality of the workers is very low because most of them are appointed as political favours 'You are of this party? Go in and work. I don't care about your professional qualifications... Let him in and hire him!' This has been going on for years, and obviously this creates a substantial problem of quality."

cannot actually fight the system once elected. Capable individuals (such as those appearing in Chapter Four) who are appointed often fail in their reform efforts because they are 'islands of efficiency' with little backup.

A high turnover of individuals also breeds suspicion and can discourage investment. Because of the turnover of ministers in the sector, and because principal-agent problems apply to different extents with different officials, the difference in a negotiated oil contract from one year to the next can be enormous. This discrepancy increases the likelihood that an incoming minister will question an overly generous contract, comparing it with a stricter one.[233] Regardless of the actions of the rest of the Ministry of Energy, when a minister threatens publicly to unilaterally renegotiate a contract—even a generous one—this makes the sector less attractive to investors and further delays reforms involving increased private involvement.

Thirdly, as a result of all of this, Ecuadorians have very low levels of trust in the state, undermining some reforms which require trust. While they may not know all the details, Ecuadorians are aware of the corruption and incapacity within their state, and this jaded pessimism has real effects on attempts to reform. The 2004 LatinoBarometer showed that Ecuadorians perceived high amounts of corruption in government. Asked 'how long will it take to eradicate corruption', 53% of Ecuadorians answered that it 'never will be'—equal highest in Latin America. Other data in Chapter Five revealed the deep disillusionment of Ecuadorian citizens with their state, their leaders, their democracy, and their ability to affect the institutions of governance. A major problem faced by Elsa de Mena in the IRS was convincing Ecuadorians to pay tax when they doubted revenue would be used fairly. Ecuadorians are also reluctant to support reforms which require trust in the executive or state. In Chapter Three, we saw that a lack of confidence in the state was at the heart of the failed attempts to remove the LPG subsidy and channel the savings into pro-poor spending. Only if the poor families who repeatedly rose up to protect their subsidy had faith in a credible, efficient state—or in their ability to reassign power to those who would deliver—would it be rational for them to support eliminating the LPG subsidy. In Chapter Two we saw that one way of building credibility could have been to use the party of the poor and the indigenous, Pachakutik, as a bridge between state and citizenry, and that a unique opportunity was wasted in 2003—when other parties

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[233] Interviews, former Ministers of Energy, Quito 2005.

were discredited, but Pachakutik, new to the political party scene, retained an image of purity (which it, too, lost after six months). Pachakutik was unique in having this credibility while also commanding genuine mass participation, and moreover was a natural part of the incoming Gutiérrez administration. We can now appreciate what a lost opportunity this was. The same issue can be seen with electricity reforms. The population need to trust they would be better off in the long term if the state temporarily raised the tariff, catalysing a more efficient generation sector, better-focussed social spending, and lower costs in the long run. Each of these three reforms would have increased state revenue; delaying them further debilitates the state.

Let us consider the specific impact of 'instability'. It has two major effects. Firstly, Chapter Five showed how instability helped create veto players. If incapable executives already have trouble dealing with veto players, it follows that as veto players become more numerous they will find it harder. Each of the three steps above rested on the existence of this first vicious circle. In a climate of instability, a weak, vulnerable executive cannot rein in those who steal from the state; corruption worsens; and Ecuadorians become more cynical still.

Secondly, instability has an important effect on reform by disrupting processes of governance directly. When the government falls, plans and programmes are abruptly cancelled. Even if they are reinstated after a time, the protracted delays and uncertainty undermine reform efforts. [234] At the individual level, political appointments are replaced with each (frequent) change in the ruling coalition. Middle and upper management is often replaced after leadership changes; in this thesis, we saw this occur in crucial state institutions such as Andinatel, Petroecuador, and the IRS.[235] The high turnover of individuals in public office compounds the problems already mentioned. Even if an inexperienced political appointment has a genuine desire to learn and perform the job well, they are likely to be gone just as they are getting to know the sector. As a former Undersecretary for Electricity said, "Even if they're Einsteins it takes them six months to learn."[236]

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[234] The telecommunications reforms, as we saw in Chapter Three, died by 'a thousand cuts' as they were repeatedly delayed.

[235] MEF positions have at times also been highly politicised; Minister of Economy Rafael Correa in 2005 offered to reinstate the 74 MEF workers dismissed by his ideological opposites in the previous (Gutierrez) administration (*El Comercio* 2005d).

[236] Interview, Marcelo Neira, 5 April, 2005, 8am, Quito: "They last just months. Because the president wants Congressman X to help him out in Y project... and one of the bargaining tools is being able to name a manager of an electricity company. 'If you name my cousin to this post, I will support you'... and many of these people are immoral and will rob money."

Although Ecuador's instability certainly worsened during 1995-2005, the country has experienced a high turnover of officials ever since democratisation, especially in the most economically-important ministries. The high turnover of policy-makers and managers within the oil sector is a significant obstacle to reform. From 1997 to 2005 there were thirteen presidents of Petroecuador, with an average tenure of just 7.2 months (see table 6.1). The Gutiérrez administration was particularly unstable, with four Petroecuador presidents. From 1979 to 1996, those occupying the roles of Minister of Economy and Minister of Energy each averaged just one year.[237] Ministers of Education lasted slightly longer at 16 months. Mejia-Acosta, Araujo *et al.* (2004) found that on average, Ecuadorian ministers changed every 15 months.[238]

Table 6.1: Presidents of Petroecuador since 1997

Name	Dismissed/Resigned	Tenure (months)
Hugo Bonilla	April 2005	4
Luis Eduardo Camacho	December 2004	7
Pedro Espin Mayorga	May 2004	9
Guillermo Rosero Aviles	June 2003	5
Gustavo Gutiérrez	January 2003	6
Rodolfo Barniol	July 2002	29
Jorge Trujillo	February 2000	1
Wilson Pastor	February 2000	2
Manuel Echeverría	December 1999	1
Jorge Pareja Cucalón	November 1999	8
Ramiro Gordillo	February 1999	5
Luis Roman Lasso	August 1998	9
Rafael Almeida	October 1997	8

Source: Various newspaper reports

Rigidity in appointments often depends on union strength. Those who enter collective contracts, especially those negotiated by the powerful strategic sector unions, may be difficult to remove later.[239] In contrast, almost the entire staff of the IRS were dismissed when Saavedra replaced de Mena. Even when appointees cannot be dismissed, this is more likely to produce 'bloat' than continuity; following leadership changes, those appointed for their loyalty to old leaders are unlikely to be

[237] Arteta and Hurtado (2005:157).
[238] The time period was unspecified in their research.
[239] This was the case for 140 highly-paid Petroecuador managers appointed on indefinite contracts under Gutierrez; if dismissed within five years of their appointment, they were to be given five years' salary (*Hoy* 2005b).

given responsibility over politically-sensitive areas (which, as Chapter Four showed, encompasses most state economic activity).

This state of affairs has sparked two recent trends, as the Ecuadorian electorate responds to the corrupt, inefficient system they know exists. Unfortunately, both trends only *further* decrease executive capacity. Firstly, Ecuadorians have supported overthrows of their presidents, replacing them with interim administrations. Secondly, they have elected 'outsiders'. Each brings particular challenges for reform in Ecuador. I consider both in turn.

Since 1996 an interim president has served out the remainder of a presidential term three times: Alarcón, following Bucaram; Noboa, following Mahuad; and Palacio, following Gutiérrez. Since interim governments enter office in turbulent times, their problems reconciling political instability with reform are particularly acute. This was immediately apparent in all three cases. Firstly, by definition, interim governments arrive during times of political turmoil—a coup, an ousting, a death, an assassination. As the honeymoon discussion in Chapter Four showed, successfully implemented reforms tend to be concentrated at the beginning of an administration, when popular approval and congressional support is highest. But interim governments arrive unexpectedly. They have not had a long lead time during an election to select a cabinet and prepare plans for governance. There are so many pressing problems for an interim president on assuming office that economic reforms are likely to be delayed during the very window of time most conducive to passing them.[240]

Then, many reforms depend on government credibility, which is at its peak in the initial stages of office. While interim governments have not had the negative advertising an elected government has suffered at the hands of its opponents, neither are they able to use to electoral campaign to build credibility and trust. Rather than being elected with political capital to spend which can be used to push through unpopular reforms, Ecuadorian interim governments have tended to arrive with a deficit of political capital. The 'ruling triumvirate' which took over from Mahuad was quickly deposed, and interviewees testified that Noboa and his economic team were operating in such a politically tumultuous environment, especially in the early days emerging from the crisis, that they did not know whether they would be in power

[240] Moreover, there may not be an awareness of the importance of making reforms early on. The quality of political advice given to the incoming president may not be high, since their succession has tended to be a surprise and they tend not to have been surrounded by an experienced political team.

from month to month.[241] There is thus a strong disincentive to embark upon any reform which might further damage their fragile hold on power. Instead, interim presidents have tended to concentrate on forming a cabinet and winning congressional support. Interim presidents have usually responded to their lack of popular mandate by increasing social expenditure and public sector wages, and to their lack of congressional support by strategically distributing key posts.[242]

An example illustrates. Noboa did not need a political party to run as vice-president, and had none. When he became president unexpectedly he thus lacked congressional support. As the country was highly unstable economically and politically throughout his term as the fallout from the economic crisis and the *coup d'état* continued, Noboa was forced to make an alliance with the PRE in return for naming Carlos Julio Emanuel as Minister of Economy (see Chapter Three). The instability associated with his interim presidency was a vicious cycle: Emanuel's corrupt behaviour caused a major political scandal and ultimately increased instability. An earlier interim president, Alarcón, suffered a similar problem, as the constitutionality of his succession was questioned. In contrast, elected president Gutiérrez gathered his congressional coalition together during the election period itself, with opinion polls giving clues as to the final form of Congress. Even before he took office, Gutiérrez met with the Central Bank and IMF, and several ministers served on his campaign; Noboa had no chance to have such meetings.

Thus for interim presidents, short term issues of survival and creating a workable majority crowd out any long term issues which are not crucial to immediate political survival, even if they are crucial to the country's welfare. There is then little time to make up the lost ground, as interim presidents serve only the remainder of the elected president for whom they are acting. One official under Noboa gave "lack of time" as the major reason for the failure to implement planned reforms, complaining that Conam had to make a two-year plan for the Noboa administration and that "you really can't do anything in two years."[243]

Once the interim administration's short term is up, it is back to 'business as usual' elections. But electing a government in the traditional manner is certainly no

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[241] Interviews, officials involved with Noboa administration, Quito and Washington 2005.
[242] As we saw in Chapter Two, both Alarcón and Noboa raised spending considerably. Palacio has shown early signs of doing the same. Alarcón aimed to shore up support from the public sector when he created a special bond for MEF employees, then extended it to all workers in central government. Noboa again extended the bond's coverage, to cover all workers in the public sector.
[243] José Peñaherrera, Legal Director of Conam 2000-2002, 7 April, 2005, 4.30pm, Quito.

guarantee of a capable executive. This is because of the second way Ecuadorians' disillusionment has latterly manifested: through electing inexperienced 'outsider' candidates, of which the Gutiérrez administration is the best example. In the remainder of this chapter, I show that fragmentation and disillusionment combined during Gutiérrez' term to produce extreme executive incapacity. The executive could not manage the political side of reforms skilfully, and also lacked technical capacity to implement them. Gutiérrez had no natural pool of talent from which to draw his technocrats and political appointments. He therefore appointed friends and family, debilitating the agents of the state. There is general recognition that Gutiérrez' nepotism was worse than other presidents' in terms of quantity, and much worse in terms of quality.

The lack of capacity in the Gutiérrez administration can be traced to two facets of the political system. Firstly, the political party system is so fragmented that it is unclear which presidential candidates could conceivably make it through the first round of voting. This means that independent qualified people who wish to back the winning candidate and secure posts in the subsequent government are spread thinly around many candidates. Candidates fill the gaps in their campaigns with friends and family. Secondly, there is widespread lack of confidence in all parties owing to corruption scandals, broken electoral promises, and economic and political crises. Because of the antagonistic, fragmented, ineffectual and corrupt political system, parties and individuals who attain political prominence tend to be tainted by association. Scandals and crises are blamed on the government and politicians of the day, even when events have been years in maturation. The most dramatic example of this was the fall of the mainstream DP party, blamed for the 1999-2000 economic crisis. The DP had been a major party since democratisation but, following the fall of Mahuad, was riven with conflict and ceased to be a credible electoral option (see figure 5.2). In short, participating in politics virtually always discredits the participants, and Ecuadorians have not re-elected those who have been discredited—that is, everyone.[244] Having exhausted the mainstream parties and unwilling to vote for a president from the same party twice, Ecuadorian voters turned instead to the smaller 'outsider' parties and to candidates whose party was invented solely as a

[244] Bucaram's strong polling performance throughout his time in exile in Panama is a significant exception.

vehicle for their presidential campaign. This eventually produced Gutiérrez, the ultimate 'outsider'.

Gutiérrez was an 'outsider' on multiple levels: geographically, politically, economically, socially and even within the military, the state institution from which he drew his support. As we have seen, Ecuador's regional antagonism is an important factor in voting. Gutiérrez lacked the natural support of *either* Quito *or* Guayaquil. He came from neither the coast nor the sierra, the two regions where the vast majority of the population lives, but from the Amazon town of Tena (popn. 13,000). Needless to say, no presidential candidate had come from there before.

Politically, both Gutiérrez and his party were outsiders. Gutiérrez himself lacked any formal political or electoral experience. The PSP was established just before the election campaign purely as a vehicle to elect Gutiérrez. The party's full name, the 21st of January Patriotic Society Party, makes reference to the *coup d'état* in which Gutiérrez (and several PSP officers) played a major part, explicitly branding the party as iconoclastic and anti-oligarchic. Having come through the first round of voting with only 17% of the vote, Gutiérrez was not considered a credible candidate until extremely late in the campaign. Even the month of the first round, he was still being referred to only in the last paragraph of news reports as an 'also-running', consistently polling around 10%.[245]

Economically, the contrast between Gutiérrez—a former army colonel with no family wealth to supplement his salary—and Álvaro Noboa, his rival in the second round and the richest man in Ecuador—could not be greater. Gutiérrez appealed to poor Ecuadorians by emphasising his outsider status vis-à-vis Noboa. Even against another more typical candidate, Gutiérrez would have been unusual for lacking substantial personal wealth or an established family name. Ecuador's compulsory voting law, while not entirely enforced, ensures high returns for candidates who appeal to the vast majority of poor, uneducated Ecuadorians. Gutiérrez' message was "I am one of you"—an outsider. Militarily, Gutiérrez was of low rank (a colonel), and acted against many higher officers when perpetrating the 21 January *coup d'état.* After he came to power many high-ranking officers, especially the generals, were encouraged to retire and, if they did not, were dismissed or marginalised. Colonels and lieutenants who had followed Gutiérrez were rapidly promoted.

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[245] See, for example, *Latin America Weekly Report* (2002c).

In social terms, Gutiérrez is a manifestation of a longer-term trend. He rose amidst the slow political decline of many of the old powerful landowning families of Ecuador. As a generalisation, the old families had tight control of Ecuadorian politics until the end of the Durán Ballén administration (1992-96). That is, even under the centre-left Borja administration (1988-92) there were strong links to the old powerful families. In the Durán Ballén administration a large number of the cabinet had such links. Bucaram (1996) was closely tied to coastal business networks and called his own cabinet the "benign oligarchy".[246] Under Gustavo Noboa, who himself comes from an oligarchic family[247] the old families made somewhat of a comeback. Gutiérrez, however, eschewed them altogether. In almost every way, he was consciously and unconsciously an outsider.

Despite running on an anti-corruption platform, once in office Gutiérrez began to name unusually high numbers of friends and family to official positions. Over 30 of Gutiérrez' blood relatives and in-laws, and 17 of his immediate political circle were spread among ten public sector institutions, according to a newspaper investigation in mid-2003.[248] Some of these made further familial appointments: Gutiérrez' brother-in-law Napoleón Villa installed his own relations in several institutions,[249] and Gutiérrez' friend Patricio Acosta controlled the distribution of positions in the executive branch and key provincial offices. An independent NGO watchdog, Probidad, reported that Lucio Gutiérrez' brother Gilmar, cousin Renán Borbúa and wife Ximena Bohórquez had relatives in public posts managing various sectors.[250] The report said it was public knowledge that Gilmar Gutiérrez had "direct influence in the administration of oil contacts and in the employment of personnel in Petroecuador". Gutiérrez' niece's husband Danny Jarrín was placed on Petroecuador's Administrative Committee, which awards contracts. According to Probidad, journalists frustrated the efforts of Gutiérrez to name more friends and relations to government positions.[251]

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[246] Terneus (1996).
[247] Unrelated, however, to presidential candidate and banana magnate Álvaro Noboa.
[248] These included the Ministers of Foreign Affairs, Government, Human Development, Energy, the National Secretary of Sport, and many placements in state institutions such as Andinatel, Pacifictel, the Solidarity Fund, Emergency Social Investment Fund, National Finance Corporation, and several ministries (*Hoy* 2003g).
[249] *Hoy* (2003g).
[250] López (2003).
[251] *Hoy* (2003e). Gutiérrez admitted that relatives worked for him, but insisted that none occupied public roles due to his influence (*Hoy* 2003a).

Gutiérrez had a circle of five key political advisors/people with influence throughout the campaign: Patricio Ortiz, Patricio Acosta, Renán Borbúa, Napoleón Villa and Guillermo Lasso. Three of these were rewarded with control of state entities. Ortiz and Acosta, veterans of the 21 January *coup d'état*, were rewarded with the Social Welfare Ministry and Administration Secretariat respectively. Although Vice-President Palacio was said to want the job, Napoleón Villa—Gutiérrez' brother-in-law—was given charge of the 'pearl of the state', the Solidarity Fund, whose accounts have never been audited. He thus had control over the two telephone companies, six electricity-generating plants, 18 electricity distribution centres and the electricity transmission system.[252] Additionally, the development project 'Aliméntate Ecuador' allegedly became an important source of political patronage for him. After Gutiérrez fell, it was discovered that the staff was full of nieces, nephews, cousins, other relations, and friends of Villa or Gutiérrez' brother, Congressman Gilmar Gutiérrez. Many of these would have had access to important sources of funds and political favours due to their role in the project, and the distribution of resources under the project was heavily questioned.[253]

Gutiérrez filled other gaps with members of the armed forces. One newspaper summed up the situation one year into the Gutiérrez administration: "Where there were administrators, now there are majors, lieutenants and captains."[254] A former colonel and co-conspirator in the 21 January coup, Hugo Bonilla, was appointed head of Petroecuador in late 2004, although he had little experience of the oil sector.[255] Gutiérrez had pledged in March 2004 to distance the armed forces from political institutions by ending the participation of military officers from serving in public offices, but it appeared that this promise was overridden by a need to ensure the support of the armed forces following his near-loss in the attempt by opposition parties to impeach him. In telecommunications, for example, Gutiérrez installed former members of the armed forces in key roles, such as the second lieutenant made the manager of the National Telecommunications Advisory (Conatel).[256] In fact in the telecommunications sector only those who presided over the Boards of Andinatel and Pacifictel were *not* military officers—and one of them was a family member (in

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[252] *BBC Monitoring Internacional Reports* (2003b).
[253] *El Comercio* (2005b).
[254] *El Comercio* (2004d).
[255] Bonilla is a civil engineer but "his experience of the oil sector appears to be limited to having run a company that provided services to Petroecuador, according to a report by Dow Jones"(Kerr 2004).
[256] *El Comercio* (2004d).

Andinatel, Roció Bohórquez, the First Lady's sister). Pacifictel was led by Hugo Quevedo, son of the former President of Congress, and friend of Abdalá Bucaram's son Jacobo. With these connections, and with no university education, Quevedo's appointment was strongly criticised by the Guayaquil City Council, who claimed his presence fulfilled part of a PRE 'quota'.[257] Finally, many 'clients' were appointed from the PSP. In Petroecuador, a traditional repository for political favours, 400 posts with indefinite contacts and high remuneration were occupied by PSP members.[258] In an unusually explicit recognition of the practice of using public posts as political favours, on assuming office Gutiérrez did not name directors of customs in four coastal regions (Huaquillas, Manta, Esmeraldas and Guayaquil), 'saving' them to use as bargaining chips in constructing a congressional majority.[259] As we saw in Chapter Four, customs is a source of rents prized by coastal parties and their patronage networks.

Neither corruption nor nepotism are new to Ecuador. But the difference with Gutiérrez was the combination of the very high quantity and very low quality of political appointments.[260] While some interviewees disparaged Gutiérrez' intelligence ("a clown") and elites repeatedly expressed disdain for Gutiérrez' lack of education and managerial experience, some who had worked closely with him were more complementary, speaking of his intelligence and pragmatism, while adding the caveat of his inexperience. As one high official put it, "He is smart, a sponge. He absorbs everything." However, even those defenders criticised his lack of experience, and there was total unanimity regarding the low quality of some of his appointees.

Several appointees to key ministries lacked any experience of their sectors. An oft-cited example was Carlos Arboleda's appointment to the Ministry of Energy, a key ministry, and later to the Deposit Guarantee Agency. Arboleda, a former colonel and friend of Gutiérrez, was acknowledged by "oil company executives and political adversaries alike" to lack any grasp of the oil sector.[261] Raúl Baca (former Minister of Energy and Gutiérrez' own Minister of Government) said, "He was completely

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[257] *Ibid.*
[258] *Hoy* (2005c). Some were at high levels, such as the son of PSP member of Congress Luis Columbo, Cristián, who was Deputy Manager of Administration of Petroproducción
[259] *Hoy* (2005a).
[260] Bucaram's appointments were perhaps the closest in terms of lack of experience and education to Gutiérrez. However, Bucaram's administration only lasted six months, so the impact of these inexperienced appointments was lesser.
[261] *Alexander's Gas and Oil Connections* (2004).

ignorant of the sector that he had to manage." As another official complained, "With the greatest respect to him, what does he know about oil? How can you ask him to implement a reform designed by the IMF and the MEF when he doesn't understand how to?"[262] Officials of long tenure in various roles and various political backgrounds complained about the incapacity and inefficiency of several other institutions headed by Gutiérrez appointments.[263] As one official lamented, "I worked in the Treasury. I had nothing to do with things like the school meals programme. It wasn't my job. But a lot of times *I* met with the multilateral organisations because there was no information from the areas meant to be executing the programmes." Quevedo, as mentioned above, ran Pacifictel, one of the largest companies in Ecuador and a strategic asset, despite having had no university education. While its Sierran counterpart Andinatel thrived, Pacifictel's losses mounted under Quevedo. By 2005 it was near bankruptcy.[264]

There was universal agreement among officials and politicians from a variety of ministries, institutions and parties that Gutiérrez' appointments' individual capacity was lower. Moreover, the form of appointing friends and family was seen as more brazen. As one official put it:

> "The people before, they did the same thing but in a different way. They weren't as explicit about putting their cousins, friends etc in a role so public. They would give them an ambassadorship somewhere, or give them state contracts. Something less transparent.... Gutiérrez doesn't know how it works, so he does ridiculous things like name a colonel to the Ministry of Energy, a captain to the Solidarity Fund, another captain to Pacifictel. You want to name your friends, but don't put them in places where they could do damage! Better say, 'I'll send you to Europe as ambassador, you'll be important'. That's how they did it previously."[265]

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[262] The official continued, "The case was similar in the Solidarity Fund, the Deposit Guarantee Agency, and in other programmes like those of the IDB and the World Bank, in the social areas: Ministries of Health, Social Welfare, Housing... well, it's a terrible list." Interview, Quito 2005.
[263] As a former Minister said, "All of these fundamental sites are being managed by untried, experimental, incapable people." Interview, Quito 2005.
[264] *Business News Americas* (2005b), *El Comercio* (2005e).
[265] Interview, Ecuadorian high official, Quito 2005.

The incapacity of Gutiérrez' appointments undermined reforms in five ways. Firstly, the political neophytes struggled to manage the executive-legislative relationship. Mejía Acosta describes how presidents in weakly-institutionalised presidential democracies cope with fragmented loyalties by forming 'ghost coalitions' to pass their legislation in Congress.[266] These ghost coalitions are formed with parties and individuals, and are regulated by means of mutually-acceptable payoffs while allowing each partner to maintain their public reputation as opposed to one another and thereby their political identity. Mejía Acosta shows that the negotiating strategies of presidents need to change as their political support changes.[267] 'Ghost coalitions' are not the sole purvey of presidents, but are also constructed by the opposition. Members of the Ecuadorian Congress interviewed attested to the complex, ephemeral nature of these alliances, "sometimes formed in a matter of minutes", even between those parties that are—in theory—furthest from each other on the spectrum. For a President to win in this game takes sophisticated political sense, excellent advice, or long experience—preferably, all three. In contrast, newspaper columnists remarked during the congressional consideration of the customs legislation that the PSP—with brothers Gilmar and Lucio Gutiérrez at the helm—simply did not know how to form coalitions in Congress, how to play parties off, or how to nurture areas of agreement.[268] The last-minute failure of the emergency bill to reform the electricity and oil sectors in 2004 is one example of—as *Gestión* wrote at the time—"the complete incapacity of the government's political team to find common ground".[269]

Secondly, the sheer administrative skill needed to bring the reforms to fruition was lacking. The institutions run by these friends and family were often enormous and complex bureaucracies charged with implementing radical changes to intransigent sectors, against resistance from highly-organised entrenched interests. Some members of the economic team were very frank about their low opinion of the personnel appointed by Gutiérrez: "The institutions that should have done the reforms were headed by incapable or inexperienced people... So we had to say to the IMF, 'You know, *we* agree with you, but this guy is the one who needs to do it... and he doesn't

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[266] Mejia-Acosta (2004).
[267] Namely, when at the beginning of their administrations their mandate and popularity is at its peak, presidents are free to form public alliances, and are able to concede policy as part of a coalition deal. Later, partners have more disincentives to ally with the government as its approval ratings fall, and the price of co-operation thus rises, as does the need for secrecy of the process.
[268] *El Comercio* (2003d).
[269] *Gestión* (2004b)

want to do it, and he couldn't even if he did'."[270] Additionally, where Gutiérrez' friends and family were put into public roles, the institutions they headed often assumed unprecedented powers.[271] Friends and family also had key roles in the administration even when not formally appointed to a position. Guillermo Lasso was said to overrule Foreign Minster Nina Pacari, for example, and Napoleón Villa outranked Vice-President Palacio when it came to who got to run the Solidarity Fund.[272] Additionally, there is some evidence that the influence of the friends and former workmates of Gutiérrez who made up part of the cabinet outweighed the opinions of those members of cabinet who had been appointed on merit and were more qualified for their roles. Such appears to be the case with both Ministers of Economy during the Gutiérrez administration. Neither Yépez nor Pozo were personal friends of Gutiérrez and there were occasions on which less-informed members of cabinet who had a closer relationship with Gutiérrez are said to have overruled their proposals.[273]

Thirdly, the reform agenda was formulated and sequenced without considering how managerial capacity might affect implementation. The timing of the agreement early on in the Gutiérrez administration, while it had the 'early mover' advantage discussed in Chapter Five, also meant negotiators could not evaluate new appointments and prioritise reforms according to the administration's administrative and managerial capacity to implement them. The IMF negotiations did not—and could not—take into account the 'softer' issues of administration and management. By January 2003 even though some appointments had been made, they were unknown quantities. Neither the IMF nor the MEF could predict which institutions would be weakened by Gutiérrez appointments and which would remain strong.[274]

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[270] Interview, MEF official, Quito 2005: "Both cases existed... but I think that it was more common that people were just not capable."

[271] For example, the Ministry of Social Welfare, run by Rene Ortiz, extended its domain when Gutiérrez transferred the School Nutrition Programme from the Education Ministry to the Social Welfare Ministry by executive decree. Additionally, Ortiz' Ministry of Social Welfare was of much more importance during the Gutiérrez than the Noboa administration because it controlled the 'Social Front', which includes health and education.

[272] Mejia-Acosta (2004).

[273] Interview, Quito businessman and former politician, Quito 2005.

[274] An Ecuadorian official involved in the negotiations commented along these lines, "What you don't know, what the IMF doesn't know, is who exactly is going to be in charge in which area. Everyone agreed on what had to be done. But it's all about administration, management. The negotiations were all about what had to be done, and everyone knows that, so it was easy. But they never discussed who would do it, or how." Interview, Quito 2005.

Fourth, the loss of political capital associated with these appointments decreased the government's overall credibility and therefore ability to create and maintain coalitions to effect reform. Gutiérrez had campaigned on a left-wing and anti-corruption platform, but had almost immediately renounced his left-wing credentials by signing an IMF agreement. Dramatically undermining the other half of his platform by appointing so many friends and family was the last straw. This loss of political capital compromised the ability to pass reforms through the legislature. Moreover, the close network of familial, personal and political appointments in the state institutions introduced a conflict of interest undermining any efforts at privatising and improving administration.

Finally, the lack of capacity of several high appointments was quickly apparent and turnover was high. Rather than attempting to impeach a minister in Congress, opposition parties highlighted their incompetence. "I have no accusations of dishonesty against him, but he doesn't understand a thing about oil," PSC leader Leon Febres Cordero said of the Minister of Energy, Carlos Arboleda. Arboleda was dogged by such accusations and lasted only a year in the role.[275] The incapacity of some appointments frustrated experienced personnel, and some left. Luis Eduardo Camacho, the head of Petroecuador, had considerable experience working with private oil companies in the Ecuadorian oil sector but only lasted seven months because of tensions between himself and Gutiérrez' appointment. Similarly, Minister of Government Mario Canessa resigned, apparently out of frustration over the tight control the president's inner circle was exerting on decision making.[276] On appointment, another Minister of Government Raúl Baca stood out for his long experience in government and because he was not close to Gutiérrez, had not worked on the campaign, and—so far as Gutiérrez had an ideology—did not subscribe to it. Baca was incorporated into the cabinet for his connections with the social sectors, after Gutiérrez had been in government for a year and was suffering the breakdown of the indigenous alliance and strikes from several sectors.[277] But he lasted less than a year in office, one newspaper reporting that he was hampered because he never

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[275] *World Refining* (2004).
[276] *EIU Business Latin America* (2003a).
[277] Interview, Raúl Baca, 6 April 2005, 9am, Quito. Asked whether he thought those in the Gutiérrez administration were less capable than other governments, Baca said, "This government has no capacity for anything. They are continually confused about the actions they should be taking... You can't govern by improvising."

formed apart of Gutierrez' "intimate circle".[278] Gutierrez had *six* Ministers of Government during his term, contributing to the disjointed political management of his administration and its reform agenda.

Thus we can trace a direct line from the 'outsider' status of Gutiérrez, a result of the interaction of entrenched features of the Ecuadorian political system, to his small pool of managerial talent and, by various paths, towards the undermining of reforms: a lack of political experience to shepherd reforms through Congress; a lack of institutional skills combined with institutional 'mission creep'; a poor match of needs and capacity in the reform agenda; a loss of political capital more generally; conflicts of interest; and high turnover.

The MEF and the Central Bank have both survived this process of institutional weakening, ironically perhaps due to the same factors that undermined the other institutions. Ministers of Economy Yépez and Pozo were also exceptions in that neither knew Gutiérrez before taking on the job. They were supported in Cabinet by two factors: firstly, the lack of economic knowledge of the other members of Cabinet and secondly, the vocal support of the US Embassy, representatives of which repeatedly congratulated Gutiérrez and his team on their economic performance. It seems Gutiérrez may have recognised that the health of the economy and the relationship with the multilateral institutions (including the positive effects on the relationship with the US Embassy) underpinned his ability to distribute posts and benefits in other sectors. Given that, the same factor that led to the erosion of other institutions of the state under Gutiérrez kept the MEF strong: a small pool of talent. Under Noboa, who was well-connected to banking sectors, the MEF was staffed with former members of the private sector. Gutiérrez, who had no such social network, had to look to the Central Bank. Minister of Economy Pozo, who came from a private bank, had also worked in the Central Bank, as had Yépez, Galarza, and many other high officials in the MEF. Because Gutiérrez lacked private sector advice on his campaign team, even before Gutiérrez took office he approached the Central Bank for advice on Ecuador's economic situation. After the election the relationships already existed and it was a natural progression to ask the Central Bank to help design his economic programme and then to incorporate them into his appointments to the MEF. This allowed the MEF to have a much closer working relationship with the Central

[278] Quevedo Terán (2005).

Bank than under either Noboa or Mahuad. It also brought stability. The MEF had been highly politicised under previous presidents, with a high leadership turnover. Under Gutiérrez, Pozo lasted 1.5 years—much longer than the 4-5 month average under previous administrations.

However, one strong, credible institution was not enough. The MEF was constrained by the incapacity all around it, and lacked influence to force intransigent institutions charged with implementation to actually do so. This partly stems from its lack of control over spending. The MEF has long been constrained in its ability to manage the economy because the vast majority of the central government budget is earmarked and cannot be redirected.[279] Rents demanded by parties in Congress often take the form of tax exemptions and earmarked tax revenues, which make the central government budget extremely rigid, undermining the MEF's (and therefore IMF's) economic influence.[280] According to Arteta and Hurtado, only about 10% of government revenues are discretionary.[281]

Meanwhile, the MEF under Gutiérrez began to be overstretched. Effective control over the areas targeted for reform remained limited. The MEF never gained control of Solidarity Fund assets, despite their forming almost 50% of the overall Ecuadorian budget. The MEF was setting unusually ambitious goals, and at the same time having to take on more responsibility than usual, as a result of the weakening of the other state institutions nominally involved in reform. The *Ley Topo* reform agenda, which emanated from the MEF, is a prime example of how the MEF's role expanded during the Gutiérrez administration to incorporate the areas administered by the Solidarity Fund, Conam, the Ministry of Energy, Social Security, and others.

As the MEF expanded its role it ran into territorial battles with other ministries and state institutions. In one episode, Vice-Minister of Finance Ramiro Galarza was called "rude", "impertinent", and "ignorant" by the Energy Minister López in a national newspaper, who felt Galarza had overstepped his responsibilities regarding a contracting process.[282] In short, the MEF had to take over part of the role of making

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[279] Under Gutiérrez, earmarking reached 5.3% of GDP.
[280] In 2004, about 83% was rigid, including 32% for wages and salaries, 30% for debt service, and 21% in transfers (mostly to regional governments and the IESS). Even the 'non-rigid' 17.3% is mostly 'inflexible', as 13% was pre-committed to investment and temporary salaries. Only US$145 million (0.5% of GDP) was both non-rigid and flexible. The World Bank Public Expenditure Review found that because of 'substantial' rigidity in the use of funds in the 2004 budget, "an already-tight fiscal situation" was becoming "an unsustainable trend" (Izquierdo, Melo et al. 2004:48).
[281] Arteta and Hurtado (2005:180).
[282] *El Comercio* (2004g).

reforms, but as a relatively small and specialised agency, and with some of the institutions which are meant to be helping to implement reforms instead *blocking* reforms, it was unable to proceed with the structural reforms. Additionally, the MEF's advice was diluted by the advice of Gutiérrez' friends and family acting as 'keepers of the gate'.[283]

For its part, the IMF's ability to help share the load of implementation is very limited. The IMF maintains contacts almost permanently with the MEF and Central Bank but only send four missions a year, leaving other veto players free to surround the president with people and advice.[284] Even if there were more contact with the IMF, it seems unlikely it would help the MEF's political influence much. This is because, as this thesis has shown, Ecuador is far from the anonymous, effective and efficient state assumed by much of the neoliberal agenda. In order to understand the consequences of insisting on a particular policy, negotiators must understand where the true loci of power in Ecuador are, how players interact and what they want. It takes understanding to sequence and time reforms appropriately, and to avoid wasting resources, including political capital. As one former MEF technocrat said, "It's very important that they know Ecuador deeply, know the unwritten rules that you see and live. Then they can understand me when I say, 'You can't do that'."[285] For the IMF to understand political factors, there needs to be personal and institutional commitment. In practice, though, the IMF often falls short. Some policy-makers, especially those active in the early 1990s, felt that the IMF lacked even a basic understanding of the constraints of a fragmented multiparty system and assumed the executive could pass whichever laws it chose to. In 2000, the IMF's orthodoxy and lack of political knowledge only compounded the haste and inexperience of the Noboa administration and the ideological purity of the MEF teams during the Gutiérrez administration. When the Ecuadorians disagreed with the IMF on political grounds, they sometimes

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[283] Tanzi uses this term to refer to close personal advisers to policymakers or friends and relatives with easy and frequent access and influence. He adds that "the role of keepers of the gate has not been analysed in the literature. There is no question that in many countries it is important" (2000:447).

[284] The IMF lacks influence compared to these political forces. As one pro-reform participant said, "The President gets surrounded by all sorts of people who whisper in his ear. And since he's not an economist, not a political scientist...The real power brokers surround the President with people and advice. They are very skilful at it and they take control." Interview, 2005.

[285] Interview, Fabián Carrillo, Ecuadorian economist who worked with IMF missions in Quito, 5 April 2005, 5pm, Quito. He also described problems convincing IMF technocrats that Ecuador could not comply with a 'zero arrears' condition.

found the Fund teams unreceptive.[286] Some members of the Ecuadorian economic team recalled a battle throughout the five-year period to educate the IMF.

The problem is not that IMF individuals are incapable of learning about domestic politics nor that they are wilfully myopic. IMF officials interviewed all attested to the importance of political knowledge,[287] and some mission chiefs and resident representatives have understood the country well. In Chapter Two, we saw how the IMF played a role in encouraging the MEF to accept Pachakutik's participation. But individuals acting in this way did so despite institutional constraints. In Ecuador, there are three main obstacles. Firstly, the IMF lacks the specific knowledge on which to base its policy recommendations. Teams do not always contain a Latin American economist, let alone an Ecuadorian economist, and never include representatives of other disciplines (historians, sociologists, anthropologists and so on). The IMF may say politics is important, but its resources are directed towards macroeconomic indicators: the balance of payments, reserves, real exchange rate, interest rates and so on. Secondly, the policy of rotating IMF team members to a new geographic region every few years ensures that little local institutional knowledge can build up. Even politically-curious and conscientious economists will take time to learn about a new country. It is not unusual for most of the IMF team to have less than two years experience in a country.[288] The resident representative is meant to provide continuity, but also tends to be there for three or four years at most. For budgetary reasons Ecuador's resident representative is under constant threat of recall when there is no programme. Partly to avoid this, the Ecuador resident also covers Venezuela. Thirdly, there is substantial inertia in the reform formula of the IMF. The situation is analysed in Washington and confirmed in Quito. Even a very open-minded IMF member would have trouble making changes to the formula decided before the visit.

In closing, I consider the failure of some attempts to change the incentives within the political system. It is no secret that Ecuador's political system is dysfunctional, and there have been many proposals for reform. In Chapter Four, we saw that 'islands of efficiency' like the IRS could be undermined because they lacked

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[286] Interviews, MEF and Central Bank officials, March and April 2005, Quito.
[287] As one IMF official said, "I think politics is absolutely recognised as something critical to relationship. Especially if a programme is in place. Can't be ignored."
[288] Members of the Western Hemisphere Department tend to stay longer; those from functional departments tend to average under 18 months.

an amenable institutional setting in which to be embedded. Attempts at changing the political system itself have been no more successful. The main way Ecuadorians have repeatedly attempted to reform their political system has been by adopting a new national constitution. The most recent—the *nineteenth* since independence—was established in 1998 by a national Constitutional Assembly.

The Assembly made an ambitious effort to solve some of the problems of Ecuador's political culture. Most significantly, it centralised power in the Presidency in four ways. Firstly, it limited legislative intervention in fiscal matters: Congress may not propose laws with tax or budget implications and may make only changes to the government budget which are neutral regarding the bottom line. Secondly, it allowed the President to increase public spending and taxes. Thirdly, it promoted cabinet stability: Congress can no longer remove ministers, as it had so many times during the 1980s and 1990s. Fourth, it abolished mid-term congressional elections, which generally produced a Congress opposed to the government, if it was not already. The Assembly also approved changes to decrease political interference in the Central Bank, to curb the proliferation of parties by eliminating those which did not achieve 5% of the vote two elections running, and to increase the independence and stability of tribunals and the Supreme Court.

The intent of these reforms was to give the country more economic and political stability. However, they had little impact on the exercise of power. A year later, Ecuador entered its most unstable economic period in a century. Over the next six years there were twelve Ministers of Economy. Jamil Mahuad, the first president following the Assembly, lasted just 16 months; although the new constitution provides for cabinet stability, during that time Mahuad had three Ministers of Economy, and although the new constitution provides for substantially increased autonomy of the Central Bank, its board had three presidents during Mahuad's time and its central function—monetary policy—was removed against protests from its governing officials. Some changes, such as the need to achieve 5% in two successive elections, were overlooked when it was inconvenient for whichever political grouping was in the ascendant to abolish an ally (the tiny MPD party, which coalesced with the government in 2003, has been one beneficiary of lax enforcement). As with the niceties of constitutional succession, rules and laws in Ecuador could simply be ignored when necessary. One of the intentions of the Constitutional Assembly was to increase the independence and stability of the legal system by preventing Congress

from impeaching judges, but a PSP/PRE-led coalition flagrantly violated the new provisions and dismissed the Supreme Court judges in December 2004. Similarly, although Congress may not propose bills to increase public expenditure under the new rules, it has done so anyway.[289]

Other changes were enforced, but simply had little impact. In 1977, reforms were introduced to require parties to participate nationwide, with no discernible impact on regionalism.[290] The 1998 constitution abolished mid-term congressional elections, which had customarily produced a late-term Congress even more firmly opposed to the president. But this gain was offset by Ecuadorian voters' new practice of electing 'outsider' presidents with miniscule party support in the first place. Similarly, although Congress could not directly remove ministers, parties could withdraw support from the president and make it clear that a minister was the cause, forcing the president to dismiss the minister. Restrictions on congressional interference in the budget-setting process could be similarly circumvented. In short, the efforts to centralise power in the Presidency were focussed on surface rules and structures, when, as this thesis has showed, the problem is much more deep-rooted.[291]

Conclusion

This chapter explored the impact of executive incapacity on reform within the Ecuadorian political system, highlighting the way executive incapacity was caused by and also exacerbated some of the features of the system introduced in Chapter Five. The first aspect of this was the inability of executives to deal with veto players, the second the direct impact of executive incapacity. The chapter argued that Ecuador offers particular challenges for an executive, to which the Ecuadorian executive has not risen. Like Chapter Five, this chapter then traced the detrimental impact of instability on reform attempts. Executive incapacity is exacerbated by instability in several ways: it disrupts terms, reforms and individual tenure; it dissuades capable

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[289] Mejia-Acosta, Araujo *et al.* (2004:13).
[290] *Ibid.* Mejia-Acosta, Araujo *et al.* (2004:7).
[291] This seems true also of other 'quick-fix' proposals, such as the idea said to be in vogue at the Organisation of American States to create a new constitution—the twentieth since independence—taking power from Congress and giving it to the President. There are two problems with this suggestion. Firstly, the formal powers of the Ecuadorian president are already among the strongest on the continent. Secondly, as we have seen, opposition to reforms does not have to be channelled through Congress to be effective. It is the credible threat of veto which matters, and that threat can be levied through the courts, in the streets, *or* in Congress. Because the problem is one of societal structure and, at root, political culture, there is no institutional 'quick fix' solution.

individuals; and it sustains a debilitating system of political appointments from the lowest to the highest public servants. Executive incapacity is a major contributor to policy-making that is capricious, inconsistent and incoherent even within a package of reforms. Ecuadorians' two reactions to this—ousting a government and replacing it with an interim administration, and electing an outsider—have not solved the problems but rather have introduced their own. We saw in this chapter that Gutiérrez is not part of the traditional patron-client political apparatus, but a product of Ecuadorians' reaction to it. Even though his election was a reaction to the system, his 'outsider' status still undermined executive ability to implement reforms.

As Ecuadorian voters continue to protest the system itself, the chances increase that interim administrations will replace elected ones, and that 'outsider' candidates from small and new parties will be elected. This means candidates are chosen who tend to have a smaller and less experienced pool of talent to call upon. Meanwhile, the phenomenon of educated Ecuadorians being scared off public service only continues. Chronic instability, MEF overstretch and high personnel turnover also continue to undermine attempts at reform. The combination of these factors clearly undermines executive capacity, and thus impedes reform.

We have now completed the investigation of the three factors found to impede reform in Ecuador: legislative opposition, societal veto players and, finally, executive incapacity. Each of the three have been traced back to factors highlighted by the institutional literature as impediments to reform. In each case, instability appears a major culprit in creating the conditions within which reform attempts fail. In the conclusion, I reflect upon the implications of this analysis.

Conclusion

Ecuador has become stuck in a poor political equilibrium, a series of vicious cycles. Instability breeds executive vulnerability, which attracts threats of overthrow, which when successful breed further instability. Lack of confidence in the state prevents necessary reforms occurring, which exacerbates state incapacity, which breeds further lack of confidence in the state. Patronage networks replace the state in some key functions and are a gateway to accessing state resources, which further debilitates the state and attracts unaligned individuals, thus further strengthening patronage networks. Disillusionment with politicians and parties results in support for 'outsider' candidates whose poor performance once elected further entrenches disillusionment with politicians and parties. The result is a generalised call of *¡Que se vayan todos!*, 'Out with them all!'

Since Ecuador is stuck in such a poor equilibrium, it is no wonder that crisis is suggested as a response. It was noted in Chapter One that crisis is often seen by the political economy of reform literature as a means of shaking up a system, and that the idea that economic crises aid economic reform had been taken up by some international policy advisers who recommended that policy-makers "wait until things get really harrowing" before launching reforms.[292] Similar comments regarding Ecuador were made in interviews for this thesis. One official even suggested the best thing for Ecuador would be a breakdown of the oil pipeline, "or better still, a permanent rupture, an earthquake, perhaps the oil wells could catch on fire." This thesis warns against such strategies.

The overarching challenge of this thesis was to explain lack of reform in Ecuador in the context of factors we might expect to facilitate reform. Chapter One introduced two strands of argument arising from political economy of reform literature. The first held that weakness drives a country to capitulate to an IMF agenda in negotiations. The second held that as a country emerges from crisis, its domestic political configuration makes it particularly amenable to reform. The combination of the two seemed to indicate that a country emerging from a deep economic and political crisis and entering IMF negotiations would be likely to reform along IMF lines.

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[292] Corrales (1997:620).

And yet this did not occur in Ecuador. Ecuador remained unreformed despite major crises and dramatic shocks; in fact, in the 1980s there *was* a rupture in the SOTE, then Ecuador's only pipeline, and oil exports ceased for six months. Arteta and Hurtado note eleven supply shocks received by Ecuador since the beginning of the 1970s, including oil shocks, El Niño, war with Peru, and financial crises.[293] None of these have 'shaken up the system'. In the period considered by this thesis, both dollarisation and the IMF reforms were expected to 'shock' the system, forcing Ecuador to modernise and become more competitive and efficient. Neither of them did so.

Clearly, at least one of the two propositions was wrong or partial. This thesis examined both; let us review the findings one by one. The first proposition (weakness drives capitulation) was examined in Chapter Two, which found that it fit the Ecuadorian case imperfectly. In two of the four chronological 'stages' considered in Chapter Two, leaders' perception of weakness did hurry along IMF agreements. But Chapter Two found no simple or direct relationship between 'weakness' and agreeing to IMF agreements. Ecuador's most ambitious agreement came in 2003 when Ecuador was at its strongest, the economic team using the IMF to push neoliberal reforms it believed in. An explanation which centred on negotiator autonomy found that crisis was the most significant constraint when leaders perceived Ecuador was in crisis, based on their subjective understanding of the state of the economy. When leaders perceived no crisis, the constraints placed on actors by their constituencies and their position in the political cycle were the main determinants of whether agreement was reached—and leaders themselves had a hand in creating these constraints through their decisions of whether and who to appeal to (based on their ambitions and ideology). All those things being equal, the different between agreement and non-agreement could be a simple strategic decision to achieve quite ideologically-similar outcomes.

While the first proposition was problematised but not dismissed, this thesis was more critical of the second proposition (crisis catalyses reform). In investigating this proposition I suggested a way to incorporate the empirical findings of some of the political economy of reform literature in a better explanation of policy stasis. Namely, Chapter One defined and elaborated a 'veto player analysis', aiming to account for

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[293] Arteta and Hurtado (2005:173).

why veto players appear, endure and are willing and able to continue to exercise their veto even after crisis. 'Veto players' were those able to bring a system down if denied their policy choice, a task which is easier when a system is unstable. The chapter further proposed that several variables highlighted in an empirical 'institutional' subliterature impeded reform by providing an unstable environment in which veto players could proliferate. This appeared a promising explanation of reform failure, consistent with the Ecuador case.

Having developed the theory, the thesis proceeded to test it empirically. Each chapter shed light on an aspect of the connection between crisis and reform within this framework. Chapter Two showed that crisis *can* increase technocratic autonomy and catalyse agreement, but also that while this helps to generate an agenda, it can simultaneously undermine factors which will be needed to help implement that agenda. Through a careful analysis of evidence in seven case studies, Chapter Three established that reform was promoted by a small group of neoliberal technocrats who had the authority to agree on an agenda, but did not have the ability to implement reforms. Their institution, the MEF, was overstretched and lacked support from other institutions of the state. In a context of executive incapacity, a proliferation of societal and legislative veto players who fed off consecutive regimes' instability were able to block reform. Chapter Four checked this finding against four so-called 'successful' reforms, confirming that executive incapacity and societal and legislative veto players had to be neutralised or avoided in implementing reforms. That chapter further found that although crisis can function as a background condition by increasing autonomy and insulating reformers, reforms can be later unravelled. Even reforms which were implemented were either not sustained, or failed to meet their stated aims.

For a deeper analysis of the impact of crisis and instability, it was then necessary to understand what caused executive incapacity and enabled veto players to proliferate. Chapter Five examined the root causes of legislative opposition and societal veto players and Chapter Six, executive incapacity. Each explained the outcome in terms of factors found in the institutional literature to impede reform elsewhere. Chapter Five examined the factors of fragmentation, polarisation, clientelism, and a proliferation of undisciplined, unstable, non-programmatic parties; Chapter Six examined a "feeble, dysfunctional" state, low capacity of elites, state institutions and bureaucracy. Each chapter found these features did appear to apply to

Ecuador, showed how they erode capacity and allow veto players to proliferate, and then showed how instability exacerbates the problem.

As a whole, this thesis makes two particular contributions to the academic literature. The most important regards the crisis-reform hypothesis. So far, the crisis-reform literature has not considered the existence of an equilibrium of instability; I consider what happens when crisis occurs in an unstable context. In Ecuador, instability exacerbated several factors found to make reform harder, meaning crisis has the opposite effect on reform from that assumed or argued in much of the literature. The thesis argues that paradoxically, instability is at the root of policy stasis, and that in exacerbating instability, crisis therefore impedes reform. It first provided a theoretical explanation for why the predicted outcome did not occur in Ecuador, then tested and confirmed it empirically. Chapter Three in particular showed that the reform calculus is complex, that advocating reforms requires sophisticated knowledge of politics and society, and that insisting on reforms without understanding the local dynamics of crisis and reform could bring more costs than benefits.

The second contribution arises from the development of a 'veto player' analysis as a useful way of investigating reform stasis. The heart of this thesis was a veto player analysis of the seven 'failure' cases. I confirmed that veto player analysis, if carefully defined, can be a helpful explanation of policy stasis, and that it can particularly help to explain policy stasis *after crisis*. The political economy literature has tended to underplay the role of veto players, and the concept tends to be under-theorised. In this study, the veto player analysis provided the link between the underlying equilibrium of instability, worsened by crisis, and the failure to reform. Studies not interested in the crisis-reform connection may still be interested in how this thesis specifies and applies the veto player concept, considering how it might be used in real world and, especially, developing country contexts. In Chapter One I identified several methodological advantages of the approach.

Let us consider the ability to generalise these findings. This thesis has examined a single country, which might seem to limit its generalisability. However, the single-country approach was necessary because of two advantages it offered over comparative studies. Firstly, concentrating on one country permitted an investigation deep enough to understand who the important players and veto players are, connections between reforms, and how events related and created opportunities and constraints. Secondly, it allowed for internal comparisons. In fact, this 'single country

case' contained eleven different cases, seven 'failed' and four 'successful' reforms. The advantage of this over multi-country comparisons is that country-specific variables such as culture, national history, ethnic composition, historical relationship with multilateral agencies, geopolitical significance, electoral and political system (*etc.*) can all be kept constant. This allowed this thesis to focus on a small group of variables which did change within the time period of this thesis: the nature of the presidency (elected and interim), stages in the political cycle, the makeup of congressional coalitions, oil prices and several macroeconomic variables, individuals in various roles, and, of course, periods with and without IMF agreements. These two advantages make the study more internally robust.

Furthermore, a single country study can still have general implications. Of course, like all countries, Ecuador has a unique history. But Ecuador's situation results from a combination of variables which are found in many countries. Though Ecuador may be particularly unstable or politically fragmented,[294] it is not *exceptionally* so. Many countries also have high levels of incompetence within the bureaucracy, or well-developed patronage networks. The findings of this thesis therefore reveal the result of a particular combination of common elements. The theoretical framework of this thesis drew on the empirical findings of other country studies, and since Ecuador falls into line with these findings, the conclusions of this thesis provide hypotheses and theory which could easily be applied to other country cases.

Comparative research could shed light on other combinations of these variables found in many countries. Notwithstanding the advantages of a single country study, comparative research would also have one key advantage: the ability to vary the variables kept constant in *this* study. In particular, future research could deepen the analysis along three dimensions, representing variations in the most significant variables in this study. On each dimension, Latin America offers a wealth of potential comparisons while allowing many historical, geopolitical, social and

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[294] Many officials of multilateral agencies who have tried to do similar things in several countries said in interviews that Ecuador was more complex, more unstable, less hopeful, with a weaker government and less consensus than any other country they had worked in. IMF officials who had worked in Africa, Central Asia and several Latin American countries said Ecuador was the hardest case ("diabolically complicated", as one said). Some officials commented that the importance of power 'behind the scenes' was starker in Ecuador than elsewhere, including larger Latin American countries like Mexico or Argentina.

cultural factors to be kept relatively constant (acknowledging, of course, that there is diversity on all these factors within the region).

Firstly, studies could vary the key independent variables identified in this thesis. To do this, research could compare the Ecuadorian case with other examples of *policy stasis* (for example, Bolivia, Peru, Argentina), focussing on their levels of executive capacity, clientelism, fragmentation, and the consequent proliferation of veto players. Although literature has linked these features to policy stasis empirically, it has not tended to do so via the concept of veto players, so such an analysis would further test the utility of the concept, and comparison would investigate the relative significance of each of these factors. Within the family of *policy stasis following crisis*, comparisons could focus on crises of different types, intensity and duration. Different types of crisis (political, military, economic, currency, resource...) may create different kinds of political instability, conditioning the way veto players are able to credibly threaten the regime.

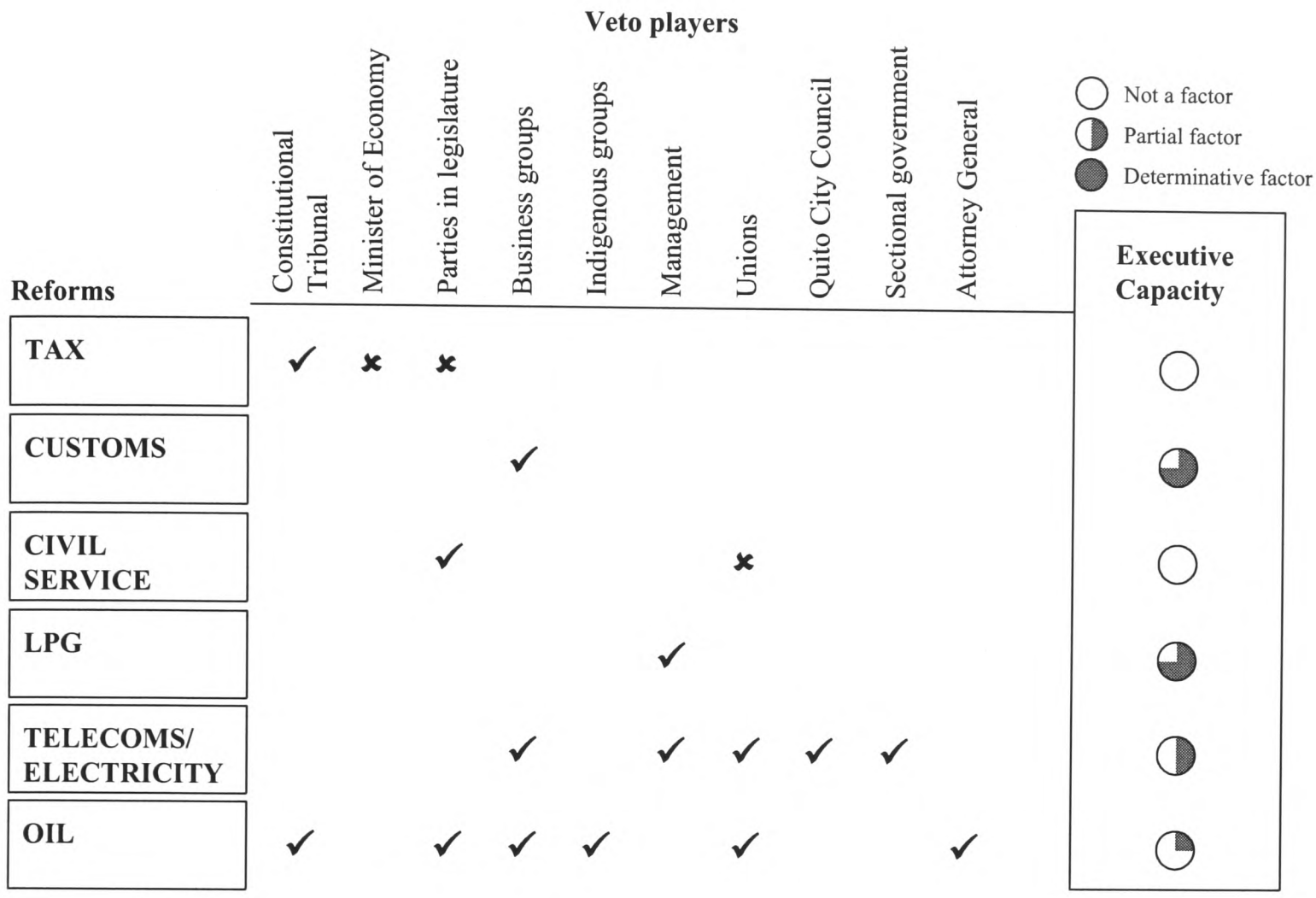
Secondly, studies could vary the dependent variable, the crisis-reform sequence. A veto player analysis would be useful in cases of *reform following crisis*, enquiring as to whether the same underlying factors existed. If they did, then it must be the case that either they did not produce a proliferation of veto players (in which case, why not?), or that veto players were somehow overcome or persuaded to permit reform (in which case, how?). Even given the conclusions of this thesis, such research would benefit from keeping an open mind on potential benefits of crisis in this process.

Thirdly, studies could explore the historical roots of these independent variables within a comparative framework. Individual country studies could place more emphasis on history and anthropology, going back further in time to explain how the system developed. Then, studies could compare the way systemic features highlighted in this thesis arise from particular development models. This could be done in global or regional terms by incorporating a discussion of historical, institutional and geopolitical incentives (for example). Or, on a comparative basis, it could relate the variables considered in this thesis to the relative tolerance for overthrowing an incumbent regime, which may depend on a country's specific history. Ecuador's willingness to overthrow its leaders may be related to its relatively benign military dictatorship, as compared to other Latin American countries (Chile, for

example) whose citizens today show much less enthusiasm for bringing down the government.

At the very least, this study provides an hypothesis which should compete with received wisdom and strike a note of caution in the minds of policy-makers who might think crisis helps. If, like Ecuador, the country is stuck in a poor political equilibrium which is based on regime instability, crisis is likely to make things worse rather than better. When crisis hits a system in which chronic instability allows veto players to proliferate, the result is policy stasis. In such a situation, despite the best efforts of reform coalitions—even when supported by a large, well-resourced external institution—reform remains elusive.

Appendix A: Summary of Reforms



Appendix B: Presidents of Ecuador since the End of Military Rule

Assumed office		Reason for leaving office
August 1979	Jaime Roldós Aguilera	Died in office
May 1981	Osvaldo Hurtado Larrea	Interim term ended
August 1984	León Febres Cordero	Term ended
August 1988	Rodrigo Borja Cevallos	Term ended
August 1992	Sixto Durán Ballén	Term ended
August 1996	Abdalá Bucaram Ortiz	Ousted by Congress
February 1997	Fabián Alarcón Rivera	Interim term ended
August 1998	Jamil Mahuad Witt	Ousted, *coup d'état*
January 2000	Gustavo Noboa Bejarano	Interim term ended
January 2003	Lucio Gutiérrez Borbúa	Ousted by Congress
April 2005	Alfredo Palacio González	

Appendix C: Interviewees

Rafael Correa	President of Ecuador 2007-, Minister of Economy 2005, Professor of Economics, University San Francisco Quito
Sixto Durán Ballén	President of Ecuador 1992-96, Mayor of Quito 1970-78, Minister of Public Works 1956-60, Ambassador to the UK 2001-03, co-founder of Social Christian Party (PSC)
Osvaldo Hurtado	President of Ecuador 1981-84, Vice-President of Ecuador 1979-81, President of the National Constitutional Assembly 1997-98
Blasco Peñaherrera	Vice-President of Ecuador 1984-88, Permanent Representative to the OAS 1993-96, 2000, 2002, Minister of Government 1968, Ambassador to Spain 1997-98
Alberto Dahik	Vice-President of Ecuador 1992-95, Minister of Finance 1985-87, President of the Monetary Board 1984-85, Member of Congress 1988-92
Mauricio Yépez	Minister of Economy 2004-05, President of Central Bank 2001-04
Mauricio Pozo	Minister of Economy 2003-04, Ambassador to the United States 2005
Javier Game	Vice-Minister of Economy 2004-05, Acting Minister of Economy 2004-5
Ramiro Galarza	Vice-Minister of Finance 2004-05, Acting Minister of Economy 2004, Chief Economist of Central Bank 2002-04, Undersecretary for Economic Policy 2001-02
Jaime Carrera	Acting Minister of Economy 1997-98, Undersecretary for Budget 1999, Acting Minister of Education 1999
Bob Traa	Chief of IMF mission to Ecuador 2001-04
Trevor Alleyne	Chief of IMF mission to Ecuador 2004-05
John Thornton	Chief of IMF mission to Ecuador 1998-2001
David Yuravlivker	IMF resident in Quito 2002-05
Mauricio Pareja	General Manager of Central Bank 2005, Acting General Manager of Central Bank 2004-05
Miguel Dávila	General Manager of Central Bank 2000, Superintendent of Banks 2000-02

Leopoldo Báez	General Manager of Central Bank 2000-03, Member of Board of Directors of Central Bank
Augusto de la Torre	General Manager of Central Bank 1993-96, Economist at World Bank 1997-2005
Luis Jácome	President of Board of Central Bank 1998-99
Eduardo Valencia	General Manager of Central Bank 1990-91, Professor of Economics, Catholic University of Ecuador, Founder of Alternative Economic Forum.
Raúl Baca	Minister of Government 2003-04, Minister of Energy 1997, President of the Congress 1981-82, 1985, Mayor of Guayaquil 1977-78, Minister of Social Welfare (Borja administration), Presidential candidate 1992
Pablo Terán	Minister of Energy 2000-02
Rene Ortíz	Minister of Energy 1998-2000, Secretary-General of OPEC 1979-81, President of the Association of Oil Companies in Ecuador
Galo Abril	Minister of Energy 1995, Minister of Planning 1993-94, Coordinator of Energy and Telecommunications Modernisations 2001-03
Donald Castillo	Minister of Energy 1991, Undersecretary of Energy 1988-90, GM of Inecel 1992-96, Current President of National Electricity Council
Fernando Santos	Minister of Energy 1987-88, Vice-Minister of Energy 1984-87, Vice-President of the Quito Chamber of Commerce 2005
Samia Peñaherrera	Vice-minister of Energy 2000-02
Pablo Lucio Paredes	Minister of Planning 1992-93, Minister responsible for IMF negotiations, Executive President of Continental Bank, Director of Chamber of Commerce.
José Peñaherrera	Legal Director of Conam 2000-02, Alternate on Constitutional Tribunal 2002-03, Vice-Minister of Trade 1987-88 and 1992-93, Law Professor at University Andina
Carlos Larreátegui	President's Chief of Staff 1994-06, Minister of Human Development (superministry) 1998
Esteban Vesperoni	Member of several IMF missions to Ecuador since 2002
Lisandro Abrego	Member of several IMF missions to Ecuador since 2001

Elsa de Mena	President of Internal Revenue Service 1998-2004, President of Customs Corporation *ex officio* 1998-2004
Leonardo Zaragocin	Manager of State-owned Utilities (Solidarity Fund)
Herb Vickers	General Manager, Burlington Resources Ecuador Limited (petroleum extraction company)
Manuel Echeverría	President of Petroecuador (state oil company) 2000, GM of CITY Investing (private oil company, now EnCana) 1984, Occidental 1984-97
Henry Llanes	General Secretary of Petroecuador Workers Union 1993-08, Member of Congress 1998-2002
Andrés Pérez	President of Andinatel (state telephone company) 2001-02, Member of Andinatel Board of Directors 2000
Marcelo Neira	Undersecretary for Electricity, Borja administration; Director of Planning of Conelec 2003-05
Fabián Carrillo	Undersecretary of the Treasury 2002-04
Nelly Molina	Central Bank financial analyst for IMF negotiations in 1998-2000 and 2003
Fernando Buendía	Pachakutik (minority coalition party) representative in 2003 IMF negotiations
César Villamar	Undersecretary of Social Affairs superministry (Education, Health, Social Welfare)
Enrique Ayala Mora	Member of Congress from 1986-88, 1990-92, 2003-05 (Socialist Party), Vice-President of Congress 1986, Professor of History, Rector of University Andina
Andrew Wright	Senior Commercial Manager, Lloyds Bank Ecuador
Juan Escalante	Advisor to Ecuador's representative on the World Bank Board of Directors
Giovanni Espinosa	Operations officer, World Bank in Quito
Vicente Albornoz	Member of Congress 2000-03 (Popular Democracy), Director-General of CORDES think tank, Quito
Osvaldo Davila	National Director of Planning 1984-88, Advisory Board and editorialist for *El Comercio* newspaper 1990-95
Franklin Maiguashca	Economics Adviser to President Borja 1988-92, Senior Professor of Economics, University San Francisco Quito
Verónica Lojan	Advisor to the Vice-Minister of Finance 2003-05, Advisor to the Minister of Energy 2002

Alberto Acosta	Principal economist, Latin American Institute of Social Research. Formerly Professor of the Central University of Ecuador, University of Cuenca and University of Guayaquil. Economic commentator for 'Contacto Directo' television news programme (1990-97)
Eduardo Santos Alvite	Director of the Quito College of Economists 2003-05, economic advisor to President Borja 1992-96, Ambassador to Austria 1991, former Minister of Planning
Fausto Herrera	Coordinator of Research and Economic Programmes in the Ministry of Economy
Gaitán Villavicencio	President of Guayaquil Corporation of Regional Studies. Formerly Professor of Sociology at the Santiago Catholic University of Guayaquil
Pedro Páez	Department of Economic Research, Ecuador Central Bank. Professor of Sustainable Development, Public Economy and Econometrics at Guayaquil Polytechnic
Fander Falconí	Economist, Latin American Faculty of Social Sciences
Gustavo Arteta	Academic Director of CORDES think tank in Quito
Carlos Larrea	Professor of Economics, FLACSO (Latin American Faculty of Social Sciences)
Alejandro Cobo	Professor of Agricultural Economics, International University of Ecuador.
Alejandro Ponce	Law Professor, University San Francisco Quito
Fernando Bustamente	Political scientist, University San Francisco Quito
Carlos Freile	Genealogist, University San Francisco Quito
Francisco Hidalgo	Director-General of Research at Central Bank
Ernesto Castillo González	President of National Union of Educators, President of Ecuador Popular Front (left-wing party)
Larry Memmott	Economics Counsellor, US Embassy in Quito
Rick Waters	Acting Economic Counsellor, US Embassy in Quito
Gianluca Signorelli	US Treasury Economist for Andean region including Ecuador 2003-05

Dirk Joldersma	US Treasury Economist for Andean region including Ecuador 2000-02
Clark Crook-Castan	US State Department Ecuador Desk Officer
Sebastian Saoleo	Trade and investment officer, British Embassy in Quito
Zoë Mullard	Trade Assistant, Canadian Embassy in Quito
Walter Spurrier	Director of Guayaquil-based magazine *Weekly Analysis*
Vicente Ordóñez	Political commentator, Quito newspaper *Diario El Universo*
Julio Oleas	Economic analyst and journalist, *Gestión* magazine
Juana Ordóñez	Economic analyst and journalist, *Gestión* magazine
José Proaño	Acción Ecológica campaign against the oil pipeline
Patricio Morales	Culture specialist, Confederation of Indigenous Nationalities of Ecuador
Anonymous	Representative of the National Federation of Peasant, Indigenous and Black Organisations of Ecuador
Ampam Karakras	Executive Director, World Bank Development Project for Indigenous and Afro-Ecuadorian Villages
Fernando Carvajal	UN Food and Agriculture Organisation, Quito.
Guillermo Ordóñez	Childhood and Life Foundation (non-profit NGO)
Ric Goodman	Field worker, Oxfam Ecuador (Guayaquil)
Patricia Dávila	Economist for Jubilee 2000
Jorge Rosas González	Economist, Pichincha Chamber of Industry
Leonardo Toscano	Economist, Pichincha Chamber of Small Industry
Fabián Carvajal	Economist, Pichincha Chamber of Small Industry
Alberto Portillo	President of Cerro Sentana Micro-enterprises, Guayaquil
Luis García	Former President, Ministry of Agriculture and Livestock trade union
Señor Naranjo	National Junta in Defence of the Artisan (Quito)
Alexandra Lastra	Social Affairs policy analyst
Mateo Villalba	Social Affairs policy analyst
Patricio Guarderas	Small businessman in Quito

Pablo Hernández Self-employed Spanish teacher, Quito

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