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Case Study Report
Material wellbeing

SHARING THE FRUITS OF PROGRESS
Poverty reduction in Ecuador

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Abbreviations and acronyms

$	In this paper $ refers to US dollars throughout
BDH	*Bono de Desarrollo Humano* (Human Development Grant)
CEPAL/ECLAC	Comisión Económica para América Latina y el Caribe/Economic Commission for Latin America and the Caribbean
CONADES	*Consejo Nacional de Salarios* (National Salaries Council)
CONAIE	*Confederación de Nacionalidades Indígenas del Ecuador* (Ecuador's National Indigenous Confederation)
CSO	Civil society organisation
ECV	*Encuestas de Condiciones de Vida* (Standard of Living Surveys)
ENEMDU	*Encuesta Nacional de Empleo, Desempleo y Subempleo* (National Survey of Employment, Unemployment and Under-employment)
ENSANUT	*Encuesta Nacional de Salud y Nutrición* (National Health and Nutrition Survey)
GDP	Gross Domestic Product
GNI	Gross National Income
HDI	Human Development Index
IMF	International Monetary Fund
INEC	*Instituto Nacional de Estadística y Censos* (National Institute of Statistics and Census)
LAC	Latin America and the Caribbean
MDGs	Millennium Development Goals
MCDS	*Ministerio Coordinador de Desarrollo Social* (Ministry for the Coordination of Social Development)
MPI	Multidimensional Poverty Index
NBI	*Necesidades Basicas Insatisfechas* (Unmet Basic Needs)
PPP	Purchasing Power Parity
SDGs	Sustainable Development Goals
SENPLADES	*Secretaría Nacional de Planificación y Desarrollo* (National Secretariat for Planning and Development)
SRI	*Servicio de Rentas Internas* (Inland Revenue Service)
TERCE	Third Regional Comparative and Explanatory Study
VAT	Value Added Tax
WDI	World Development Indicators

Abstract

Latin America has historically been characterised by very high levels of persistent poverty and inequality. Since the beginning of the 21st century, however, the region has experienced deep transformations that have resulted in more inclusive economic growth, and a dramatic reduction in poverty and inequality. Even in this progressive context, Ecuador stands out. While in 2000, when the country was hit by an economic and financial crisis, 20% of the population lived in extreme poverty (defined as less than $1.25 a day), only 4% do so today. Income inequality measured by the Gini coefficient declined by 6 points (from 0.54 to 0.48) between 2007 and 2013, a fall of more than twice the regional average. Remarkable improvements were also observed in human development, especially for the poorest. Moreover, differentials between the richest and the poorest are narrowing: the gap in primary school attendance fell from 21% in 1999 to 11% in 2006 and 2.5% in 2014, and for secondary education, from 67% in 1999 to 48% in 2006 and 22% in 2014.

This case study illustrates and explains Ecuador's progress in reducing poverty and inequality, focusing on the period between 2000 and 2012. Drawing on primary interviews and secondary analyses, we argue that Ecuador's success can be explained by four main economic and political factors. First, high oil prices helped the country to achieve economic stability and growth in a context of dollarisation. Second, growth gave way to changes in the labour market that benefited the poorest people, through a decline in unemployment and an increase in real wages. Third, Rafael Correa's election in 2007 brought about radical change in adopting highly redistributive social policies. These were financed through measures to create fiscal space such as the re-writing of oil contracts, the restructuring of the public debt and the channelling of all oil revenues into the budgeting process. The poorest people also benefited from the expansion of the cash transfer programme, *Bono de Desarrollo Humano*, and the improved provision of health and education services, though these have often been used for political ends.

Today, Ecuador faces the challenge of advancing and deepening the progress it has achieved in changing domestic and international circumstances, in particular the falling price of oil and the ending of Correa's final presidential term. Further reduction of poverty will require paying greater attention to social sectors that have not shared fully in the benefits of growth, especially those living in rural areas, in certain geographical regions and the Afro-Ecuadorian and indigenous populations. In addition, the country will need to build upon the momentum it has established and channel it into a process of structural transformation.

1. Introduction

Woman selling potatoes. Photo: © Dottie Day.

Latin America has historically been characterised by very high levels of persistent poverty and inequality. Since the beginning of the 21st century, however, the region has experienced deep transformations that have resulted in more inclusive economic growth and a dramatic reduction in poverty and inequality. Ecuador, an Andean country with a population of nearly 16 million, including significant populations of indigenous and African descent, is a remarkable example of this transformation. The country reduced the share of people living in extreme income poverty – defined as less than $1.25 a day in 2005 Purchasing Power Parity (PPP) – by a factor of five between 2000 and 2012. Even omitting the crisis years of the late 1990s, the proportion fell from 10% in 1998 to 4% in 2012.[1] Economic growth and improved external macroeconomic conditions were central to this success, but equally important was a shift in government accompanied by institutional transformation, and the adoption of redistributive social and economic policies.

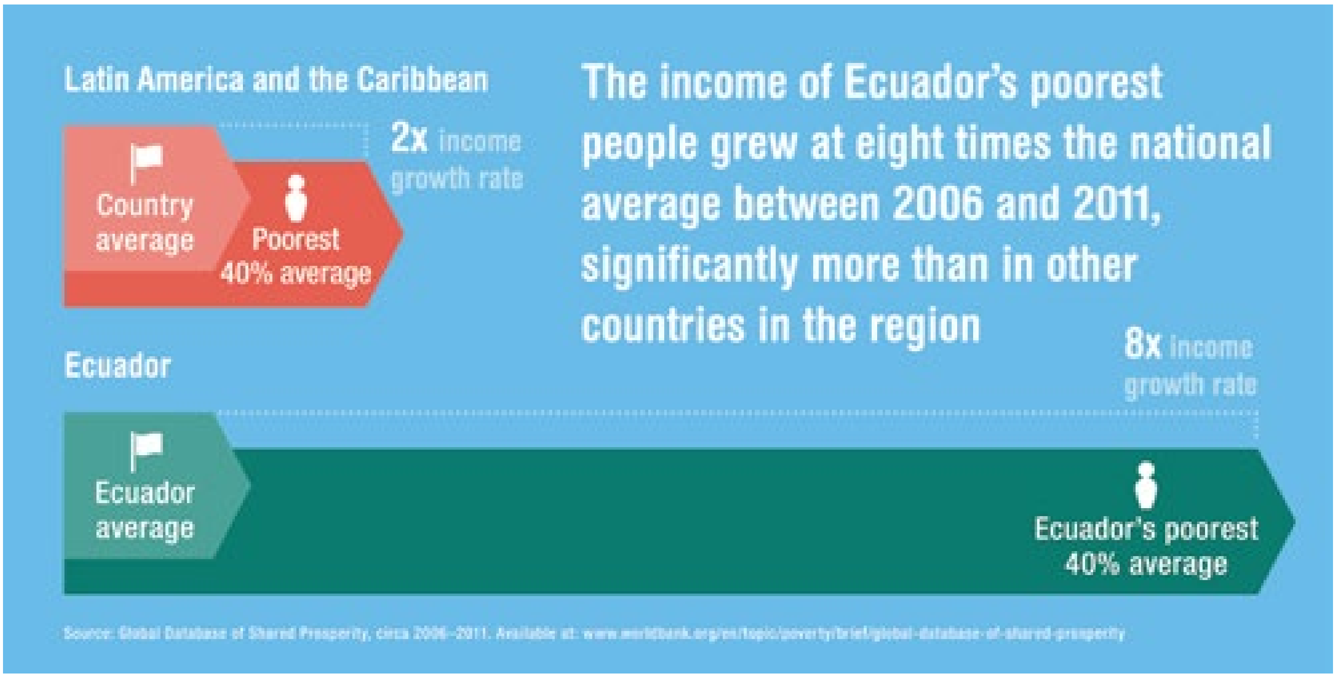
The ending of the Millennium Development Goals (MDGs) and adoption of a new set of Sustainable Development Goals (SDGs) from 2015 provides an opportune moment for a focus on experiences in reducing poverty. Poverty reduction was a key focus of the MDGs – the first target sought to halve extreme income poverty – and its importance is reaffirmed in the SDG call to 'end poverty in all its forms everywhere'.[2] Given that some experts believe it may be possible to eliminate extreme poverty by 2030,[3] it is even more important to focus on the experiences of, and challenges faced by, countries that are already on the cusp of achieving that goal. In this case study, we focus on the reduction of extreme income poverty in Ecuador from 2000 to the present.

1 All poverty data in this paragraph are from the World Bank's Povcalnet database.

2 https://sustainabledevelopment.un.org/?page=view&nr=181&type=230&menu=2059

3 See recent review of projections by Hoy and Samman (forthcoming).

Figure 1: Income growth for Ecuador's poorest



1.1 Ecuador's progress in a regional perspective

Ecuador's progress is better appreciated in the context of the transformation of the rest of the region in the same period. In Latin America and the Caribbean (LAC), the proportion of people living below the extreme poverty line of $1.25 a day has almost halved since 1995.[4] Furthermore, for the first time in the region, in 2011 the middle class (those living on $10 to $50 a day in 2005 PPP) constituted a larger portion of the population than the poor (defined as those living on less than $4 PPP a day): the shares were respectively 32% and 27% (World Bank, 2013). The Gini coefficient dropped from 0.56 in 2003 to 0.52 in 2012 (Cord et al., 2015). Overall, the recent pattern of growth in the region has been inclusive: between around 2006 and 2011, the average incomes of the poorest 40% of the population increased by 5% a year, while the average increase for the whole population was close to 3% a year. Both the growth rate of the poorest 40%, and the ratio between their growth rate and the average have been higher in LAC than in any other region in the 2006–2011 period.[5]

Even in this progressive context, Ecuador stands out. Since 2006, the country has experienced considerable reductions in inequality and in fact has achieved the world's most 'inclusive' growth if we consider the growth rate of the incomes of the poorest 40% of the population relative to the average: in Ecuador these grew over eight times the rate of the average (Figure 1). Ecuador's Palma ratio[6] fell by half between 1999 and 2012, from 5.2 to 2.6; by 2012, it was only slightly above the world average (World Development Indicators, 2015). This suggests a significant redistribution of the benefits of economic growth in favour of the poorest 40%, albeit from a starting point of high inequality.

Ecuador's success is significant because it was achieved with sustained but unspectacular economic growth – annual growth averaged 5% between 2001 and 2006, and 4% between 2007 and 2012 – and started from an average income level that was in 2000, and remains, lower than the LAC average.[7]

This progress is all the more noteworthy because it was relatively rapid. Poverty and inequality had been increasing in the late 1990s and by 2000 the country faced deep macroeconomic crisis, including a high fiscal deficit and extreme inflation that prompted the adoption of the US

4 World Bank's Povcalnet database.

5 Based on simple averages across countries in each region calculated using household surveys. They may not be strictly comparable because countries in many regions use survey data on expenditures, while those in LAC use income data.

6 The Palma ratio is the ratio of the average income of the richest 10% in a country compared to the average income of the poorest 40% (see Cobham and Sumner, 2013).

7 Growth data are from Central Bank of Ecuador. Income data are from World Development Indicators 2015.

dollar as the national currency. Yet, in less than a decade, Ecuador succeeded in catching up with the rest of the region in terms of reducing poverty and inequality.

1.2 Situating Ecuador's progress in its recent past

In addition to understanding Ecuador's progress relative to the LAC experience over the last 20 years, it is important to situate its evolution in the context of its recent past. Traditionally an agro-export-oriented economy, the country has been subject to a sequence of economic booms and crises associated with its dependence on primary products. In the early 20th century, Ecuador relied on cocoa as its principal source of foreign exchange. Cocoa production had declined by the middle of the century, and was supplanted by bananas. Bananas became Ecuador's chief export crop and Ecuador became – and remains – the world's largest banana-exporting country. Following the discovery of oil in its Oriente region in 1967, oil quickly became Ecuador's chief export and source of foreign exchange and has occupied this position ever since. Between 1972 and 1981, Ecuador's GDP grew at 7% annually, higher than any other country in LAC apart from Cuba (Thorp, 1998: 319). Fluctuations in the price of oil have exerted a strong effect on Ecuador's economy and living standards ever since. Manufacturing has remained weak: it accounted for 17% of GDP in 1940 and 1970 (ECLA, 1978 cited in Thorp, 1998: 162, Table 6.1), and still only 14% 40 years later (World Development Indicators, 2015).[8]

The reliance on an agro-export-led growth model reinforced an oligarchic social structure in which the benefits were highly concentrated. For example, at the end of the 19th century, it was estimated that 20 families owned 70% of land in the country's cocoa-growing regions (Chiriboga, 1980, cited in Thorp, 1998: 83). Banana production relied on a small and medium production base, but an oligopolistic export structure; in 1954, five companies controlled 80% of Ecuador's banana exports (Pineo, 2010). While the banana boom generated social changes – notably internal migration, growing urbanisation, the strengthening of the state and the beginning of an import-substitution growth model – these changes largely benefited the elite (Larrea, 1987). Along similar lines, the first petroleum boom did not have the anticipated positive social impacts, and indeed Ecuadorian living standards deteriorated in the 1970s (Larrea, 2006).

In the early 1980s, oil prices dropped and the 1982–1983 El Niño damaged the coastal economy. The rising pressure of foreign debt and chronic inflation led the government to adopt a stabilisation programme that further eroded living standards. In the 1980s, economic performance fluctuated in line with oil prices and by the end of the decade, facing a fall in oil prices and an inability to repay its debt, Ecuador had to adopt severe stabilisation and economic structural adjustment programmes (and liberalisation of the financial sector), alongside other countries in the LAC region. Between 1980 and 1990, the country underwent a vicious cycle of currency depreciation and high inflation leading to a process of partial dollarisation that preceded the official policy in 2000 (Gastambide, 2010). The impact was acute: the number of people living on $1.25 a day doubled between 1998 and 2000, meaning that 3 million people were reduced to extreme poverty.

Ecuador's political history is also marked by instability. Ecuador has undergone nearly 100 changes in government since 1830 and has had a total of 20 constitutions. This instability persisted through the 1990s and early 2000s. Between 1995 and 1998 alone, five presidents governed Ecuador. Against this backdrop, the election of a democratic leader who has held office for eight years is a significant achievement. Persistent populism is another key feature of Ecuador's political landscape – described as 'the most important political phenomenon in contemporary Ecuadorian history' (de la Torre, 1997: 12). It has been argued that the characteristics of populism, 'its inherent moralism, personalism and authoritarianism run counter to liberal democratic institutions' (de la Torre, 1997: 14). Since the 1980s, indigenous communities also began developing a political presence. By 1990 the indigenous movement was among the strongest in the region, with strong organisations like the *Confederación de Nacionalidades Indígenas Ecuatorianas* (Conaie). These movements' agenda has centred on finding different development paradigms (Chiriboga, 2004); their influence became critical in 2008, during the drafting of the latest constitution.

This brief summary makes clear the challenges that have faced Ecuador – an economic model that relies heavily on primary products and fluctuations in international prices, an oligarchic social structure and severe institutional weaknesses. The following sections chart Ecuador's progress since 2000, which has enabled a period of sustained improvements in people's living standards, viewed through the lens of extreme poverty.

1.3 Methodology and report structure

This case study is part of Development Progress, a six-year research project that aims to better understand, measure, explain and communicate what has worked in international development. As part of this project, researchers have conducted 49 case studies, selected according to their performance in one or more dimensions of wellbeing.

8 The ECLA and WDI figures may not be strictly comparable but they point to the low share of manufacturing in the economy.

Table 1. Main sources of data on Ecuador

Source	Type of instrument	Periodicity	Available periods
Census	Characteristics of population	Every 10 years	1990, 2001, 2010
Encuesta Nacional de Empleo, Desempleo y Subempleo (ENEMDU)	Employment, Unemployment and Underemployment National Survey	Every 3 months	Until 2003, data was yearly and only covered urban areas. Most recent: 2003–2015 (but comparable only from 2007).
Encuesta de Condiciones de Vida (ECV)	Living Standards Survey	Every 4 years	1994, 1995, 1998, 1999, 2005/2006, 2013/2014
Encuesta Nacional de Salud y Nutrición ENSANUT	National Health and Nutrition Survey	Every 4 years	1986, 1989, 1994, 1999, 2004, 2012

Ecuador was chosen as an interesting and understudied case of progress in reducing extreme income poverty.

To select suitable case studies, we sought to identify countries that had achieved the greatest reduction of income poverty from 1990 onwards. In particular, we focused on countries that reduced poverty at a high rate compared to the growth in income. We had sufficient data for this analysis to include 60 countries over the 1991–2010 period and 51 over the 2001–2010 period. On the basis of a method that sought to control for a country's initial poverty level and income growth – and that accommodated non-linear pathways of progress (see Rodriguez-Takeuchi and Samman, 2015) – we found that Ecuador was a top performer for the 20-year period and the most recent decade, according to both the $1.25 and $2.00 poverty lines (in 2005 PPP). We ranked countries according to the extent to which they exceeded the expected degree of poverty reduction for an average country with the same starting point and change in income. Using the $1.25-a-day poverty line, Ecuador was ranked 18th for the 1990–2010 period and 10th for the 2000–2010 period. Using the $2.00-a-day poverty line, it was ranked 13th and 5th respectively. An initial review of the literature and discussion of our findings with experts on Ecuador served to validate the data analysis and affirm our view that a study of Ecuador could offer useful insights into the reduction of extreme poverty in a resource-rich economy, and the associated challenges.

This case study explores the factors that enabled this fall in extreme poverty, focusing on the changes – in policies, politics and external circumstances – that shifted the benefits of economic growth in favour of the poorer sectors of the population. This report is the result of analysis of secondary literature on Ecuador's reduction of poverty, official public documents and available statistical databases (Table 1). It also draws on interviews by two of the authors with 16 experts, including policy-makers (3), researchers (8) and representatives from international organisations (5). The interviews, conducted in January and February 2015, focused on three main topics. First, the interviewers asked respondents to provide their observations on changes on poverty and inequality in Ecuador and to identify the most important changes. A second set of questions enquired about the main factors behind the reduction in poverty. A third set asked respondents to discuss the challenges or possible limiting factors for Ecuador in maintaining progress in poverty reduction. Finally, respondents were asked for recommendations on additional policy-makers or researchers to be interviewed, and on further resources that should be reviewed for the case study.

The report is organised as follows. Section 2 illustrates Ecuador's progress in reducing income poverty and inequality. Section 3 discusses the four main factors driving this progress. Section 4 presents the challenges Ecuador must overcome in order to achieve future progress, including the further reduction of poverty by addressing the structural disadvantages faced by the most vulnerable sectors of the population. Section 5 identifies lessons for other countries.

2. What progress has been achieved?

Eating maize while overlooking Quito. Photo: © Diego Delso.

This section describes trends in the reduction of poverty and inequality in Ecuador in the late 1990s and 2000s. It shows that income poverty has fallen dramatically from its peak in 2000 when 20% of the population was living in extreme poverty. Today, less than 5% of Ecuadorians are poor by this measure. Fewer people are chronically poor in rural and urban areas alike. This improvement is echoed in non-income dimensions of wellbeing as well as in multidimensional measures of poverty. Inequality has also fallen, and there is evidence of some redistribution of income, and greater equality of living standards and of access to education and health services.

2.1 Trends in income poverty

The financial and economic crises that affected Ecuador in the late 1990s led to a huge rise in poverty. The proportion of people living in poverty, defined by the $1.25 (PPP) extreme poverty line, appears to have changed little over the 1990s – it was 13% in 1987 and 10% in 1998. It doubled in just two years, reaching 20% in 2000, at the height of the economic and financial crisis (Figure 2). Since 2000, poverty has fallen markedly, reaching 4% in 2012 – just below the LAC average.

Progress in reducing poverty also needs to be assessed with respect to the higher national poverty lines in Ecuador for both poverty and extreme poverty.[9] These lack international comparability but are more appropriate in the context of Ecuador, where extreme poverty, which is measured in terms of having too little food to eat, is

9 Poverty is assessed by the National Institute of Statistics and Census (INEC) on the basis of the Living Standards Survey (Encuesta de Condiciones de Vida, ECV).

Figure 2: Ecuador's progress on extreme poverty

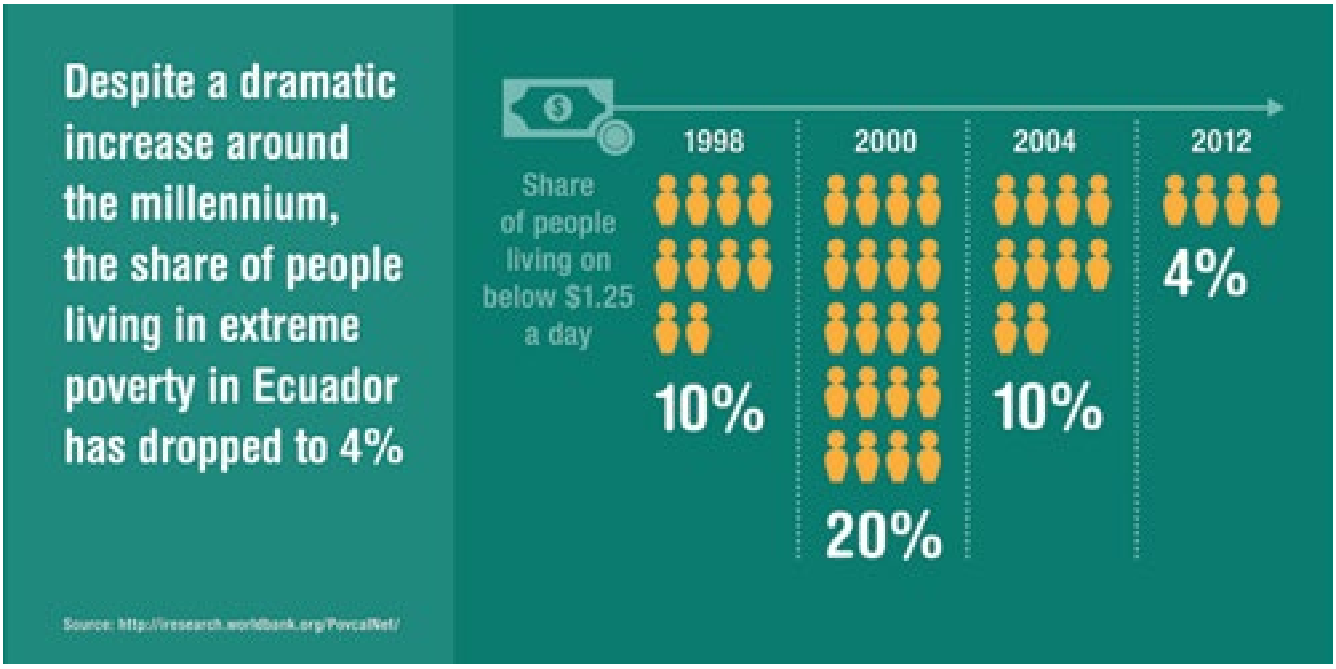
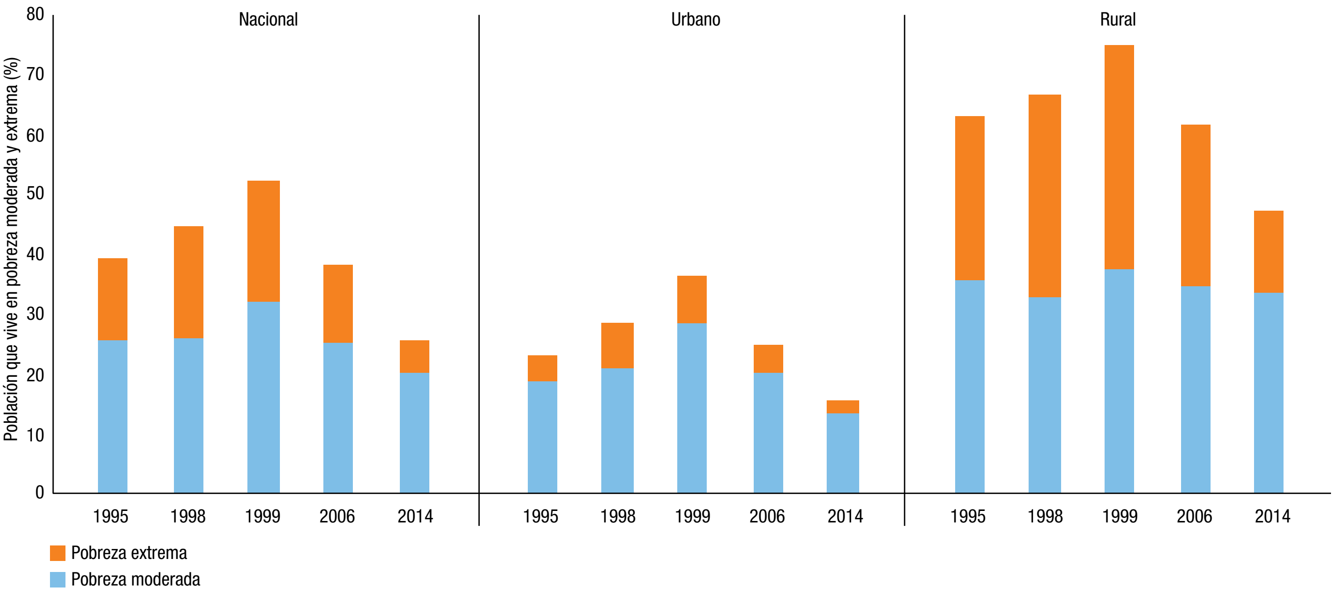


Figure 3. Share of people living in moderate and extreme poverty in Ecuador, 1995–2014 (%)



Source: INEC (2014a).

Chronic poverty[10] is difficult to assess given the lack of nationally representative panel data. Despite this shortcoming, researchers have developed ways to measure chronic poverty in Ecuador and other LAC countries. These studies use different methods and reach somewhat poor and nearly 20% of the moderately poor – experienced chronic poverty, while in rural areas, the figures were 98% and 71% respectively (Stampini et al., 2015).

Recent analysis, using a different methodology,[13] estimates the evolution of chronic poverty in Ecuador.

'Poverty is a structural problem. What we have worked on is reducing the gaps, the gaps in access to services and jobs among different groups' – Public official

It affirms that chronic poverty is higher in rural than in urban areas, that it peaked with the crisis in 1999, and that it decreased thereafter (Figure 4). The decrease was higher in urban areas (it fell by two-thirds) but was absolutely higher in rural areas (where it decreased by 34 percentage points over the 15-year period).

2.2 Poverty in other dimensions of wellbeing

This study is focused on trends in income poverty but it is important to relate these trends to non-income measures of deprivation. One measure of such trends is the Human Development Index (HDI), a composite measure of changes in health, education and income. Between 1990 and 2013, Ecuador's HDI increased by 11%, from 0.643 to 0.711. In 2013, Ecuador was in the high human development category, ranked at 98 out of 187 countries and territories, but below the LAC HDI average of 0.740.

Over the 1990–2013 period, Ecuador's life expectancy at birth increased by 7.7 years (68.8 to 76.5 years), mean years of schooling by 1.0 year (6.6 to 7.6 years) and expected years of schooling by 0.3 years (12.0 to 12.3) (UNDP, 2014).[14] Ecuador's GNI per capita increased by about 50% (from \$6,772 to \$9,998 in 2011 PPP). Excluding life expectancy at birth, Ecuador's human development indicators are below the regional average. Although all HDI indicators have improved since 1990, education indicators (mean years of schooling and expected years of schooling) have stagnated since 2005 and 2010 respectively. This suggests that growth is not translating into a direct (and immediate) demand for better education. Labour income has been the main factor driving the reduction in extreme poverty in LAC since 2003 (World Bank, 2013), although its importance relies more on greater participation in the labour force than on stronger demand for skilled workers (López-Calva and Lustig, 2010).

The HDI is a simple measure of human development incorporating just three important dimensions. Recent efforts to develop multidimensional poverty measures seek to encompass a broader array of dimensions that matter to wellbeing (Box 1, overleaf). By and large, these affirm that the broad majority of Ecuadorians have experienced progress in improving their living standards and wellbeing more broadly over the past 15 years.

2.3 Trends in inequality

As in most of the LAC region, the distribution of income in Ecuador is highly unequal: in 2011, the country's richest quintile received more than half of national income (Figure 5, overleaf). For the 2000s as a whole, it is estimated that the total share of national income held by the poorest quintile rose from 3.2% in 2000 to 4.2% in 2011, while that of the top quintile fell from 61% to 52% (ECLAC, 2013). According to the Economic Commission for Latin America and the Caribbean (ECLAC, 2014), Ecuador is one of the countries that most reduced (income) inequality in the LAC region. Between 2007 and 2013, its Gini coefficient for income fell by 6 points (from 0.54 to 0.48) while the LAC average fell by 2-3 points (0.54 to 0.50).

If inequality is examined in terms of consumption patterns, there is a trend towards equality but change is more muted. According to one widely used measure, the Gini coefficient, inequality has remained virtually constant over the past two decades – it was 0.42 in 1995 and 0.41 in 2014. This apparent constancy masks underlying change, however – the Gini coefficient increased to 0.45 in 1999 as economic conditions worsened, then decreased after 2006.

A disaggregated analysis of the 2000–2014 period shows that poorer households experienced more rapid consumption growth than households in the top deciles (Figure 6, overleaf). Between 2000 and 2006, average yearly growth of consumption was roughly 12% for all deciles except for the top one, whose consumption grew at about 9%. From 2006 to 2012, the consumption of the bottom decile grew by almost 4.5% each year, and the top decile recorded negative growth of -1.7%. Between 2006 and 2014, the share of the richest decile in total consumption fell from 35% to 32%. In 2006, consumption of this decile was 18 times that of the poorest 10%, while it was 13 times higher in 2014 (INEC, 2014b).

The improvement in income distribution is mirrored by the converging distribution of indicators of living standards, and basic health and education, between the top and bottom quintiles – this holds true for access to safe water, improved sanitation, primary and secondary education, and skilled birth attendance (Figure 7, overleaf). Data on health insurance, a higher-level indicator, also shows convergence but a high gap – three times as many households in the richest quintile have health insurance.

10 Extreme poverty that persists over years or a lifetime, and that is often transmitted intergenerationally.

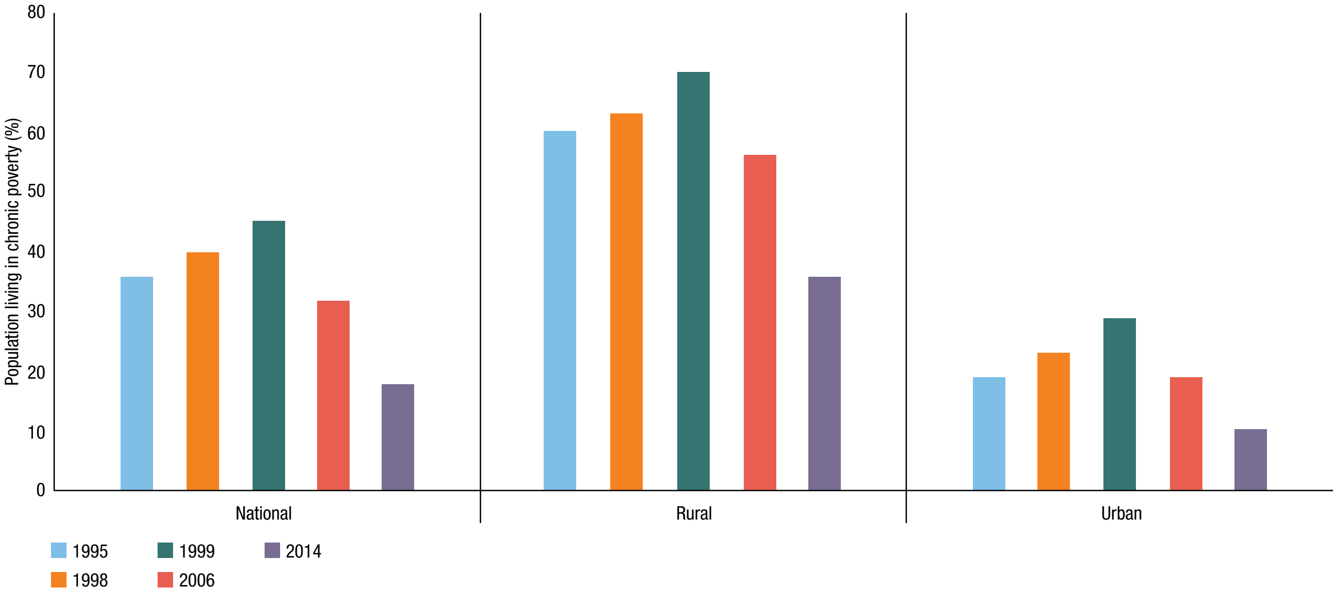
11 ECV and ENEMDU in the case of Ecuador.

12 A synthetic panel is created from two or more rounds of cross-sectional data. Various techniques can be used to predict the poverty status of individuals from earlier survey rounds in later rounds.

13 INEC (2014b) uses Katzman's methodology (Katzman, 1989) to estimate chronic poverty in Ecuador. The methodology combines direct methods (unmet basic needs) and indirect methods (income or consumption) to define four levels of poverty: chronic, recent, inertial and social integration (non-poverty). Details are available at: http://repositorio.cepal.org/bitstream/handle/11362/10278/371311421.pdf?sequence=1 and http://www.ecuadorencifras.gob.ec/documentos/web-inec/ECV/Publicaciones/ECV_Folleto_Pobreza.pdf

14 Mean years of schooling is the average number of years of education received by people aged 25 and older, while expected years of schooling refers to the number of years of education that a five-year-old is expected to attain, based on net school enrolment rates.

Figure 4. Share of people living in chronic poverty in Ecuador, 1995–2014 (%)



Source: INEC (2014b).

One admittedly simplistic approach to understanding poverty reduction is to disaggregate the change in poverty by the effects on income and redistribution.[15] In Ecuador, both played an important role: economic growth drove poverty reduction in the 2000–2006 period, and redistribution from 2006 onwards.[16] This exercise is useful in illustrating that both economic growth and the policies that sought to redistribute its benefits have been important in reducing poverty in Ecuador over the past decade. Growth was more important in the early 2000s up to 2006, while redistribution was more important thereafter. In the following sections we explore the factors driving this increased growth, and crucially, of how (and to whom) it was redistributed.

15 The growth effect is given by a proportional change in all incomes (or consumption) of a population that leaves the distribution of relative income unchanged; the distribution effect is the result of a change in the distribution of relative incomes (or consumption), leaving the aggregate income level unchanged (Bourguignon, 2004). This gives insights into whether the primary mechanism of change was higher income that affected all households equally or shifts in the way that incomes were shared – but it is provides no insights into the underlying reasons for the observed changes.

16 Over the first period, poverty fell 6.5% – the growth effect reduced poverty by 8.4% while the redistribution effect raised it by 1.9%; in the second period, poverty fell 12.5%. The respective contributions of the growth and redistribution effects were -5.4% and -7.1% (INEC, 2014b).

Box 1: Multidimensional poverty in Ecuador

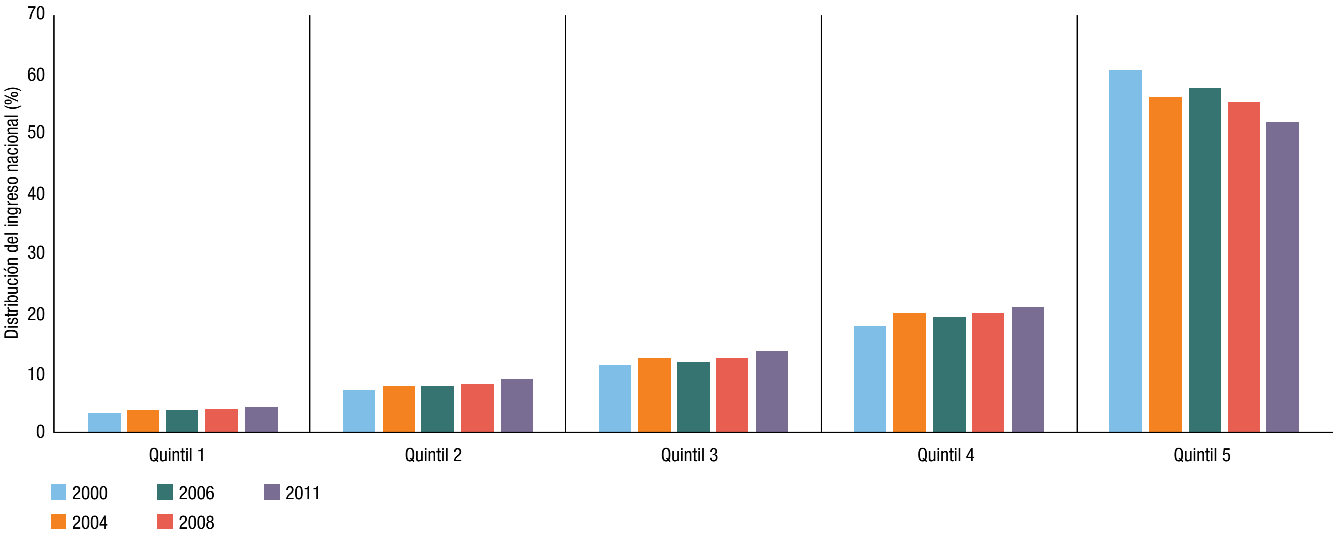
Poverty is a multidimensional phenomenon that affects different spheres of life; indicators of income and consumption poverty do not fully capture these multiple dimensions. Ecuador's Ministry of Social Development (MCDS) recognises that poverty is a multidimensional phenomenon that needs further analysis (Senplades, 2014). There have been various attempts to estimate multidimensional poverty in Ecuador. The National Institute of Statistics and Census (INEC) produces an indicator of multidimensional poverty called Unmet Basic Needs (*Necesidades Basicas Insatisfechas* – NBI), which combines deprivation in housing conditions, access to water and sanitation, the household dependency ratio and children's access to primary education. A household is considered poor if it is deprived in one or more of these dimensions. According to this indicator, multidimensional poverty fell from 65% to 52% between 1998 and 2006, and to 36% by 2014 (INEC, 2015a).

Mideros (2011) proposed a Multidimensional Poverty Index (MPI) defined by six dimensions related to the right of '*Bien Vivir*' (Living Well): food and water; communication and information; education; housing; health insurance; and work and social security. The MPI fell slightly from 18% in 2006 to 16% in 2010, with the greatest deprivations found in work, social security and health protection. This analysis suggests that a priority for reducing poverty in Ecuador is a reform of social protection, increasing the level of coverage and the risks that are covered. Deprivations in housing and education also affect an important number of Ecuadorians, mainly older people in the case of education. Mideros (2011) also found that households with high dependency ratios have higher levels of multidimensional poverty, and that poverty is more severe and harder to tackle in rural areas.

CEPAL (2014) developed a regional multidimensional poverty index (MPI) that includes monetary and non-monetary indicators of welfare, including living conditions, employment, schooling and social protection. Results show that MPI decreased in all LAC countries for the 2005–2012 period, especially in urban areas. The intensity of poverty also decreased. In Ecuador the MPI fell from 46% to 31% between 2005 and 2012, although this was above the regional MPI – 28% of Latin Americans were multidimensionally poor in 2012. Urban areas housed a lower share (20%) than rural areas (52%), and monetary deprivations contributed most to multidimensional poverty in Ecuador, followed by household assets, social protection and employment.

If poverty is experienced in multiple dimensions, then public policies to reduce it must be developed in a coordinated way across all sectors. Given that several non-monetary deprivations cannot be addressed with marginal increases to household incomes, public policy needs to focus on complementary areas such as housing, water, sewerage and energy (ibid.).

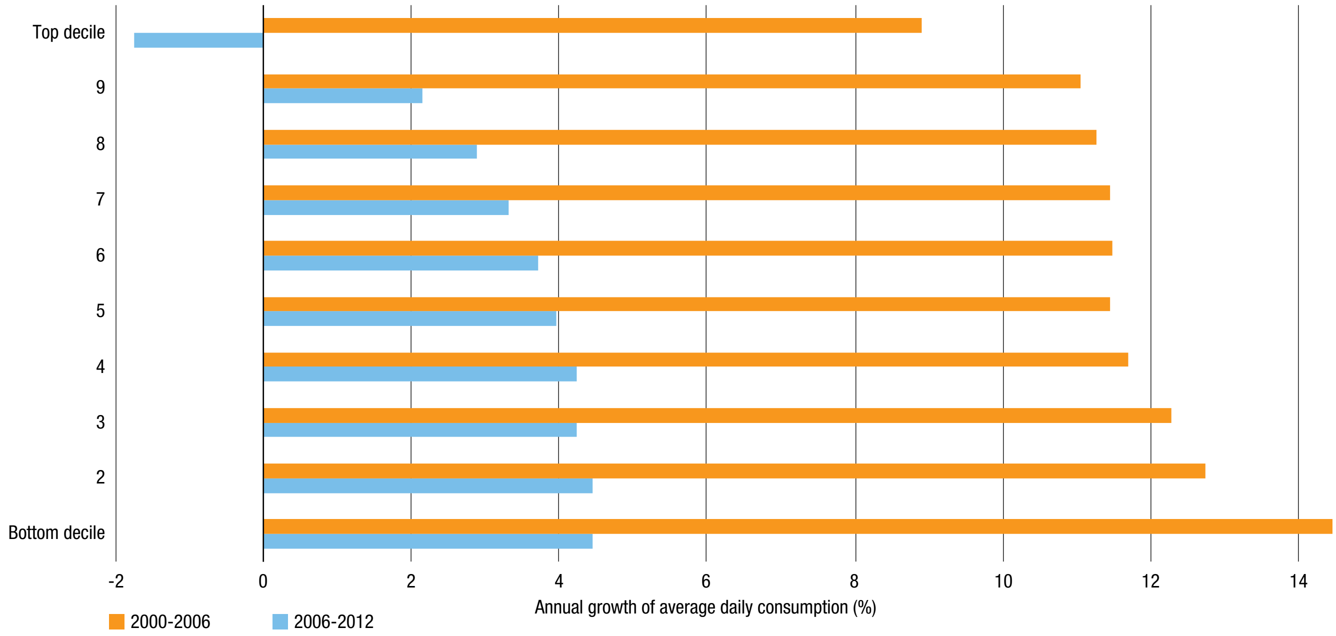
Figure 5. Distribution of national income by quintile, 2000–2011 (%)



Source: Statistical Yearbook of Latin America and the Caribbean (various years) CEPAL/ECLAC.

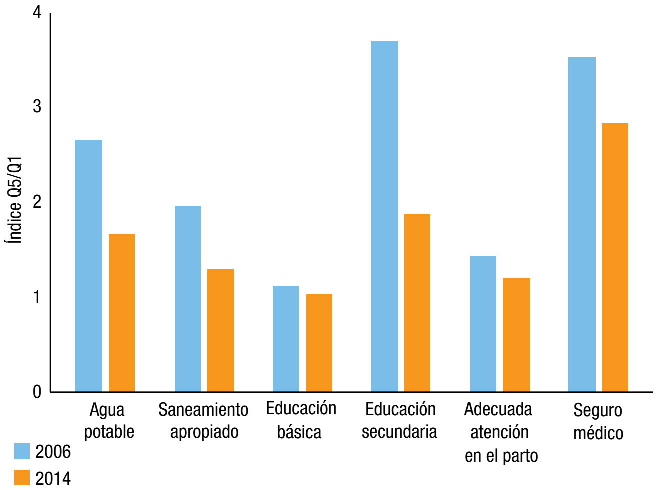
'The country has seen a reduction in inequalities, unlike any other country in the region' – Representative of an international organisation

Figure 6. Annual growth of average daily consumption by decile (%)



Source: Authors' calculations based on iresearch.worldbank.org/PovcalNet/

Figure 7. Living standards indicators: ratio of wealthiest to poorest quintile, 2006 and 2014



Source: INEC (2014b).

'I think that an important trend is the change in the conception of poverty. Ecuador now has a multidimensional perspective of poverty, and this is the perspective promoted within the state' – Researcher

3. What are the factors driving change?

Union of Campesino Organizations of Azuay. Photo: © Donna B. McNicol.

Section 2 identified three main phases of poverty reduction in Ecuador's recent history. Poverty increased sharply between 1998 and 2000, and declined slowly between 2000 and 2006 and more quickly thereafter. Each of these periods was characterised by specific economic and political circumstances. In this section we discuss how these circumstances operated differently in each period and identify four main factors driving change.

First, **the economic recovery, accompanied by a period of macroeconomic stability** resulting from a favourable international context, were coupled with tough decisions in monetary policy (dollarisation) and fiscal policy (a conservative fiscal stance until 2006). Second, economic recovery provoked **changes in the labour market,** characterised by a shift from agriculture towards services, a drop in unemployment and an increase in real wages, especially for poor workers. Third, the presidency of Rafael Correa ushered in **radical political change characterised by continuity, concentration of power and political will in support of redistribution.** The new political regime has been characterised by three elements: (a) a strong government with a political strategy based on creating direct links with citizens; (b) a shift towards redistributive social policies; and (c) radical measures to create fiscal space to strengthen the economic position of the state in the economy. Fourth, **strengthening of the social-protection framework and social services for those living in poverty** was made possible by the increase in social expenditure and emphasis on redistribution. The expansion of the cash-transfer programme, *Bono de Desarollo Humano*, and better provision of health and education services, benefited the poorest through improved childhood nutrition, increased household consumption, higher school enrolment and reduced out-of-pocket expenditure. These four factors are discussed in detail in the following sections.

3.1 Economic recovery accompanied by a period of macroeconomic stability

Those interviewed for this case study express a strong consensus that economic stability has been a key factor in Ecuador's poverty reduction. The importance assigned to economic stability needs to be understood in the context of the Ecuadorian economy in the late 1990s. Between 1997 and 2000, Ecuador suffered three shocks, which led the country into a deep economic crisis in 1999, in which year GDP contracted by 6%.[17]

The first was an environmental shock: El Niño, a recurring natural and climatological phenomenon in the Pacific Ocean, is felt in Latin America primarily in the form of heavy rains that cause flooding and landslides. In Ecuador, the phenomenon caused a natural disaster in 1997. It is estimated that at least 286 people died and a further 30,000 lost their homes (Vos et al., 1999). Flooding caused significant damage to public infrastructure and had a severe impact on poverty, as small farmers disproportionately suffered the loss of their crops. Forgone earnings in agriculture, transport and commerce were estimated to range between 1% and 10% of GDP (Vos, 1998, cited in Ponce and Vos, 2012). An estimated 2.5 million coastal people became vulnerable to malaria and cholera (Vos et al., 1999), although large shrimp farms temporarily benefited from rising waters and temperatures. El Niño was both a natural and a political disaster, since the government was unable to respond to it adequately (despite its cyclical nature), reflecting the deep institutional weaknesses affecting the country in the late 1990s (ibid.).

The second shock came from the international oil market. The country traditionally depended heavily on the export of oil and other commodities for its economic growth. The International Monetary Fund's (IMF's) indicator price for oil fell from $20 a barrel in early 1997 to below $11 in February 1999, owing to the onset of the Asian crisis and subdued demand in Japan and Europe (IMF, 2000). This triggered increasing deficits in both the commercial balance and the national budget and worsened the debt burden, which in 1999 reached 70% of GDP. The direct cost of the drop in oil prices represented 1% of GDP in 1997 and 2.7% in 1998 (Ponce and Vos, 2012).

The third shock was the financial crisis between 1998 and 1999 when 16 banks, more than half of those in the country, failed. Although the Asian financial crisis played a role, the crisis was mainly a response to structural problems in Ecuador. Banks were engaging in risky activities after the deregulation of the financial sector in 1994. The massive public debt, constant depreciations and weak public administration engendered a lack of confidence in the Sucre, the national currency. As a result, the banking system was partially dollarised even before the official dollarisation in 2000: the stock of dollar deposits in 1999 was eight times larger than Sucre-denominated deposits (Jácome, 2004). Oversight of the financial sector was more a political than a technical endeavour. To protect deposits and bail out the banks, there was a monetary expansion followed by a currency collapse. The government froze bank deposits in an attempt to control capital flight, with limited success.

The shocks that occurred between 1997 and 1999 translated into monetary instability and sharp inflation (bordering on hyperinflation in 2000, when it reached 100%) due to a lack of trust in the national currency. The situation was critical, characterised by a combination of high fiscal deficit, debt moratoria and the contraction of economic activity (Gastambide, 2010; Solimano and Beckerman, 2002). As we have seen, the impact on poverty was acute.

What enabled Ecuador's economic recovery and macroeconomic stability after these shocks was the combination of a favourable international context and tough decisions in fiscal and monetary policy.

The international context: rising oil prices

Ecuador's economy is highly dependent on oil exports, which represent up to 50% of total exports, and up to 35% of the public budget. Accordingly, the cycles of the economy are highly correlated with the price of oil (Del Cristo and Gómez-Puig, 2013), and historically governments have made little effort at countercyclical management (Table 2, overleaf).

As previously mentioned, the drop in the oil price in the late 1990s was one of the causes of the economic crisis. By the same token, the rise in the oil price between 2001 and 2006 was vital for economic recovery, since it compensated for reduced exports from other sectors while the economy was stabilising. After 2007, when the economy had stabilised, the increasing oil price continued to bolster economic growth. Oil exports became a larger share of total exports, and oil revenues accounted for a larger share of the public budget. In March 2012, the price of oil reached a historical high of $112 per barrel.[18]

'What Ecuador did was to take advantage of a favourable context, mainly strong oil prices and economic stability' – Ecuadorian researcher

17 Central Bank of Ecuador data.

18 The price of oil has fallen since 2012. Consequences for Ecuador are discussed in Section 4.

Table 2. Summary indicators of the oil sector

	Average price of Ecuadorian oil ($ per barrel)	Average annual oil exports (thousands of barrels)	Share of exports (% of total exports)	Total value of oil production (% of GDP)	Oil revenues for public sector (% of GDP)
1996–2000	16.55	65,232	30	10	6
2001–2006	32.52	48,988	45	17	6
2007–2012	78.59	62,973	53	21	13

Sources: Empresa Pública Petroecuador (2013); Fiscal indicators from Central Bank of Ecuador.

Adoption of dollarisation

In January 2000, the country adopted the US dollar as its official currency, the world's first significant economy to do so. The policy had originally been announced by President Jamil Mahuad just before he was deposed, but the vice president who succeeded him maintained the commitment ('reflecting the widespread conviction that all reasonable alternatives had now been exhausted'; Fischer, 2000: n.p).

The decision was highly controversial, however. The policy was introduced as an emergency measure to prevent uncontrollable hyperinflation and devaluation, but in the absence of wide consultation not all stakeholders were convinced by the move, including multilateral organisations and the US government (Solimano and Beckerman, 2002). Stanley Fischer, First Deputy Director of the IMF, observed that, 'The decision to dollarize was taken in desperation… If they had asked us, we would have said that the preconditions for making a success of dollarization were not in place. In particular the banking system was unhealthy and the fiscal position was weak' (Fischer, 2000).

In 1999, the government had lost control of its currency – the economy was characterised by both high inflation and constant devaluation of the Sucre. Average inflation that year was 60%, and the Sucre had devalued by 67%. By December 1999, the official exchange rate was 20,200 Sucres to the dollar. In January 2000, when the dollarisation was announced, the Sucre was devalued even further, to 25,000 per dollar based on the Central Bank's reserves. Between the financial crisis and the decision to dollarise, the currency had been devalued by 265% (Gastambide, 2010).

The impact of dollarisation was felt differently between 2000 and 2003, and following 2004.The period that followed dollarisation (2000–2003) was one of adjustment and recovery. In the first year, dollarisation was followed by an increase in prices. This particularly harsh 'once-and-for-all' adjustment (Beckerman and Cortés Douglas, 2002) led to a sharp decline in households' purchasing power. Poor households were particularly affected, and the number of people living in extreme poverty doubled. At the same time, major devaluation allowed certain economic sectors to employ people on very low wages for a short period of time. This helped with the recovery process. Specifically, between 2000 and 2003, non-oil exports grew annually by between 9% and 11.5%. Among the most dynamic sectors were fruits and processed fruits, fish, flowers, cocoa and bananas (Larrea, 2004), where poor workers are often employed.

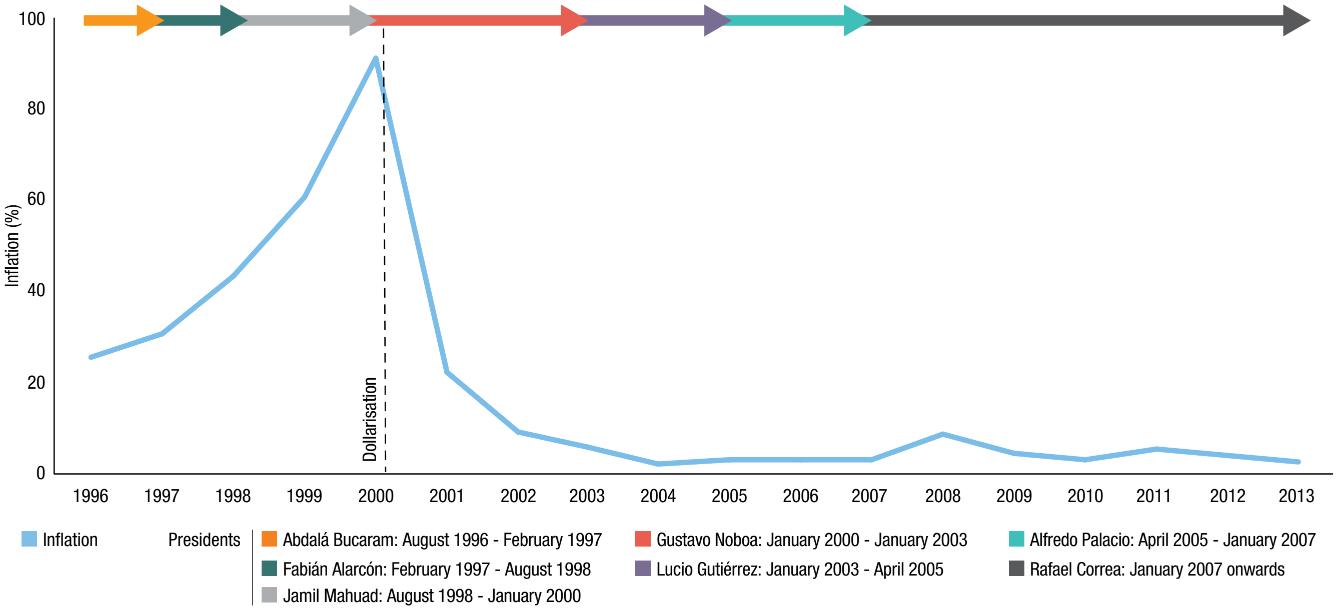
In the medium term (2004–2006), dollarisation contributed to maintaining economic stability and also had a positive impact on poverty reduction through three main channels: the control of inflation (Figure 8), the appreciation of the real exchange rate, and the change in the relative price of tradable goods (Bebczuk, 2008). The proportion of those living in poverty fell from 20% in 2000 ($1.25 a day definition) to half that level four years later, and to 6% by 2006, below its pre-crisis level.

The sharp devaluation of the Sucre that came with dollarisation was followed by an appreciation of the real exchange rate, which increased real wages. This effect continued as inflation stabilised. The average hourly real wage rose by almost 50% between 2000 and 2006 (from $0.70 to $1.00), and the increase was even higher for poorer workers – the average hourly real wage of the bottom 10% increased by 70% over the same period (from $0.17 to $0.29).[19] The appreciation of the real exchange rate also generated a shift in labour from the tradable sectors (mainly agriculture) towards the non-tradable sectors, specifically services (mainly commerce and construction). We discuss the impact on the labour market below (Section 3.2).

Further, with the price adjustments following dollarisation, tradable goods became cheaper than non-tradables. Food items are tradable, implying an important reduction in the cost of the basic basket of goods for extremely poor people. In March 2000, during the

19 Computed from data in Canelas (2014).

Figure 8. Pattern of inflation and presidential instability in Ecuador, 1996–2013



Source: Authors' elaboration based on data from Central Bank of Ecuador and historical information.

adjustment to the new currency, the average family income could buy only 37% of the basic basket of goods and services but this increased to 69% in 2001, a higher share than before dollarisation (INEC summary data on basic basket for various years).

Overall, dollarisation in Ecuador played an important role in enabling the country's economic recovery, providing stability to the exchange rate and control over inflation, whereas similar policies had failed in other countries – for example, in Argentina (Hallren, 2014). There is no evidence that dollarisation promotes economic growth. The positive role largely depended on the presence of factors, such as a favourable macroeconomic and international context and the adoption of a prudent fiscal policy (discussed below). Now that these factors are changing, the constraints that dollarisation imposes on macroeconomic management are becoming more visible. This issue is further discussed in Section 4.

Fiscal policy in the context of dollarisation

The financial crisis in the late 1990s also affected Ecuador's fiscal standing. In 1999, the government failed to service part of its Brady bond debt (dollar-denominated bonds issued by many Latin American countries in the late 1980s), and became the first country to default on these bonds. This damaged the country's reputation among international financial institutions and lenders. Before the 1997 crisis, the country risk (calculated on the basis of the Emerging Markets Bonds Index Plus) was at a historical low of 500, but it increased to over 4,000 during the crisis (Gastambide, 2010). In this context, fiscal policy played an important role in overcoming the crisis, improving the country's international credibility and promoting growth after 2006. Its importance was enhanced by the fact that Ecuador had lost the use of the other macroeconomic management tool – monetary policy – following dollarisation.

In 2002, Ecuador adopted a conservative fiscal law, which prioritised paying its foreign debt, controlling current expenditure and maintaining a balanced budget. These mechanisms provided additional controls to dollarisation, which had already limited the government's capacity to finance its deficits by printing currency. In the post-crisis period, the country maintained a stable budget, increased its tax revenues and reduced its debt stock (Table 3, overleaf). This conservative fiscal policy enabled the government to maintain a surplus from 2000 to 2006 (Cueva, 2007), and the foreign debt fell from 70% of GDP in 1999 to 21% in 2007. Experts consulted for this case study also suggested that the conservative fiscal policy prevented the negative effects of excess oil revenues on productivity, and evidence suggests that productivity increased between 1997 and 2003 (Wong, 2006). At the same time, however, this fiscal policy severely constrained public spending on social policies and poverty eradication. As discussed below, this tendency was reversed after 2007. Increased public spending was made possible by various changes in public resource management but also by the availability of resources accumulated during the period of fiscal discipline.

Table 3. Indicators of fiscal performance, various periods (%)

	Oil revenue (% of GDP)	Tax revenue (% of GDP)	General expenditure (% of GDP)	Budget deficit/surplus (% of GDP)	Debt (% of GDP)
1996–2000	6.1	8.3	23.4	-2.4	54.7
2000–2006	6.4	11.4	23.7	1.4	33.3
2007–2012	13.1	13.1	39.5	-0.8	15.5

Source: Fiscal indicators for the non-financial public sector of the Central Bank of Ecuador.

3.2 Changes in the labour market

Wage earnings make up the largest source of income for households across developing countries (International Labour Organization, 2015). They are an important means by which the benefits of growth have reached poorer sectors of the Ecuadorian population. This section examines the economic shifts in the structure of the labour market and the role of the state – both directly (through investments and regulation) and indirectly (through social protection). It then looks at the impact of these policies on the urban and rural workforce. Finally we consider the effects of international migration, an important safety net for many Ecuadorians in the years following the 1999 crisis.

Economic shifts and the role of the state

The Ecuadorian labour market has been traditionally segmented, with the formal sector attracting skilled workers and the informal sector hosting marginal and low-productivity activities with little or no regulation.[20] The crisis of the late 1990s strongly affected the labour market: 'the urban unemployment rate doubled to 14.5% in 1999, real wages lost 25% of their purchasing power, and the dollar value of the minimum wage dropped to $40 per month, undoing much, but not all, of the gains made in the earlier part of the decade' (Ponce and Vos, 2012). Analysis among income groups reveals that in 1999 the unemployment rate of the poorest quintile was 21% relative to 8% for the richest quintile (SIISE, 2005).

The macroeconomic changes described, namely dollarisation and the increase in the price of oil and other commodities, had an important impact on the structure of the economy. While growth in the 1990s was driven overwhelmingly by exports – mainly oil – in the 2000s there is an important shift toward domestic demand, which becomes the most important driver of economic growth (Table 4).

Between 2001 and 2006, the economy grew on average 4.8% yearly.[21] Growth was primarily driven by recovery in the private sector. Capital formation during that period accounted for 20% of GDP, of which 15% was private and 5% public. This coincides with a period of austerity and adjustment in the national budget. Low public investment meant that economic growth was due mainly to the expansion of exports of oil and agricultural products.

However, exports, or production to substitute for imports did not play a role in explaining economic growth between

Table 4. Disaggregation of factors driving economic growth in Ecuador, 1970–2010 (%)

	Change in GDP	Domestic demand	Import substitution	Exports
1970–81	100	100.6	-19.2	18.6
1982–89	100	-2.2	59.1	43.1
1990–99	100	1.8	2.8	95.3
2000–06	100	79.2	-10.2	31.0
2007–10	100	114.0	-11.7	-2.4

Source: Ponce and Vos (2012: 12, Table 6).

20 The informal sector represents 50-80% of labour force depending on the definition and has changed little over the 2000s (Canelas 2014).

21 Central Bank of Ecuador data.

2007 and 2010, reflecting the effects of the 2008 crisis. The government's high injection of oil revenues into the economy compensated for this, and explain the observed growth.

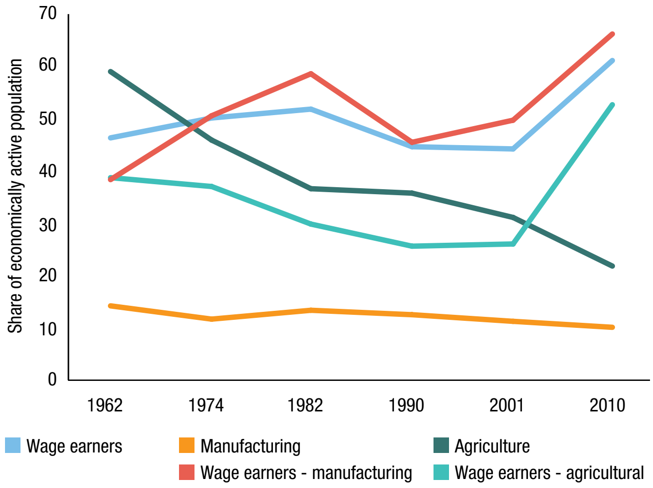
Oil, tropical agriculture and animal products (including fish) are the three key areas in which the country has a comparative advantage (Hausmann and Klinger, 2010). In the period from 2000 through 2006, some export expansion was possible because the devaluation that preceded dollarisation created the conditions for exports such as cut flowers, bananas and fish products to recover between 2000 and 2003. By 2003 exports were back to pre-crisis levels. Oil exports took off in 2004 following the finalisation of a new privately managed oil pipeline (Larrea, 2004). These additional exports were mostly from fields operated by international companies under production-sharing agreements. The post-2003 period also saw a decline in non-oil exports as a share of total exports, however (Hausman and Klinger, 2010). Although some primary products with significant comparative advantages were able to manage an unfavourable exchange rate, it was harder for newer products to compete internationally, which reduced their significance in the basket of exports (Larrea, 2004).

Dollarisation also affected the structure of the labour market by pushing workers away from the tradable sectors (mainly agriculture) towards services. The commerce and construction sectors opened up jobs for unskilled workers, and was accompanied by a reduction in the salary gap between skilled and unskilled workers.

The most reliable source of data on shifts in the structure of the labour force is the national census.[22] First, the data illustrate a move away from agriculture. While in 2001, 28% of the population worked in agriculture, by 2010 this had fallen to 21%. Nominally this meant that no new jobs were created in the agricultural sector. The commercial sector, on the other hand, created 291,000 new jobs. Other sectors in which new jobs were created include construction, transport, and hospitality and food services (297,000). In the period after dollarisation, while Ecuador became internationally less competitive, the internal market became more dynamic with richer and middle-income households consuming more and investing more, primarily in housing. This shifted opportunities to better paying sectors than the primary sector. Salaries are higher in commerce and construction than in agriculture: according to data for 2000–2006, in the construction sector, they were 8% higher, and in the commercial sector, they were twice as high (SIISE, 2005). These changes are explained by two factors: first, dollarisation, which increased consumption, including demand for imports, and stabilised interest rates that led to the acquisition of debt.

This shift in the labour market is related to greater reduction of poverty in the urban sector and persistent

Figure 9. Structure of the labour force in Ecuador, 1962–2010



Source: INEC data, cited in Larrea (2013: 13, Table 5).

poverty in the rural sector. This was significant for the poor who were able to find higher paying jobs in new sectors.

Second, according to Larrea (2013), the census data show an increase in the share of wage earners in the agricultural and manufacturing sectors. Despite a fall in the share of people employed in agriculture, the share of wage earners in the economically active population in the sector doubled between 2001 and 2010 from 26.2% to 52.4%. In manufacturing, the share of wage earners grew by a more modest but sizeable 16 percentage points (Figure 9).

In the early 2000s, as the crisis abated, the informal economy absorbed many of the workers who had been made redundant. Fiscal austerity also caused a slight decline in the share of public-sector employees, from 17.7% to 16.6% of total employment (Table 5, overleaf). The informal economy grew as a result, especially commercial and construction activities in urban areas. Over the 2000–2010 period, informality among the poorest decile increased from 59% to 87%; in contrast, informality has decreased or stayed the same among the top 40% (Ponce and Vos, 2012).

In part the result of economic recovery, and partly because workers were absorbed in the informal economy, in 2005, unemployment had fallen to 12% in the poorest quintile and to 5% in the richest. This reduction in unemployment among the poorest households is one of the means by which the economic recovery reached them (SIISE, 2005). Economic growth in 2007–2012 allowed unemployment to fall to an average of 5%. By 2012, the unemployment rate had fallen to 9% in the bottom quintile and to 2% in the top quintile. Under-employment also declined slightly but still 6 out of 10 workers are underemployed (World Bank, 2014). The decline was

22 Authors' elaboration of census data.

Table 5. Indicators of labour market performance, various periods

	Unemployment (urban) (%)	Under-employment (urban) (%)	Skill-based wage premium (men and women)*	Public employment (urban) (%)
1996–2000	10.9	48.6	0.71 – 0.48	17.7
2001–2006	9.6	54.9	0.68 – 0.59	16.6
2007–2012	5.1	51.7	0.57 – 0.42	19.9

Sources: Employment Surveys (ENEMDU); Ponce and Vos (2012) for the wage premium.
Note: The skills-based wage premium is the coefficient of a Mincerian wage equation which measures the gap between the labour income of skilled workers (those with at least a secondary education) and those who are unskilled.

driven by a reduction in the richest quintiles, while under-employment remained approximately constant in the lower two quintiles (ibid.).

After 2007, measures were adopted to increase the role of the government in the economy, including an expansionary fiscal policy. Between 2007 and 2012, inflation remained at an average of 5% and GDP yearly growth averaged 4.3%. This period presented a different pattern of growth, in which the state played a leading role. The national budget grew significantly, reaching 40% of GDP in 2012. In this period, capital formation was 24% of GDP, of which 10% was public. While from 2000 to 2006 public oil revenue was $13,000 million, in the 2007–2013 period, it increased to $62,000 million. These resources were all spent, as there were no more oil funds to save this revenue and no strong fiscal rules to limit spending.

In the same period, jobs and salaries in the public sector grew as a result of the injection of government oil revenues into the economy, as well as through direct investment. Examining the distribution of employment by income quintile, we see that those who are still poor are more likely to be in agriculture (Table 6), while those in the second and third quintiles are more likely to be employed in the service sector, including commerce and construction.

Between 2007 and 2013, the wages of the poorest quintile rose by 44% and in the richest quintile by 4.6% (World Bank, 2014). This change is also supported by a decrease in the premium of skilled workers over unskilled workers (Table 5). In this period, public employment increased to 19.9%.

The situation in rural areas differs somewhat owing to the preponderance of smallholder farmers.[23] In 2000, about 75% of Ecuador's rural population was living in poverty (SIISE, 2001) and 80% of farms were less than five hectares (ha) – the average was 1.5 ha (Censo Agropecuario, 2001, cited in Martínez Valle, 2004: 27). Family agriculture accounted for under half of household income, with the remainder earned from migratory work,

Table 6. Sectoral distribution of employment by income quintile, 2014 (%)

		Sector of economy			
		Agriculture	Oil and mines	Industry	Services
Income quintile	1	57.3	0.6	7.9	34.2
	2	38.0	0.5	12.1	49.4
	3	25.4	0.7	12.7	61.2
	4	16.1	0.8	14.0	69.1
	5	8.4	0.8	11.4	79.4
	Total	27.7	0.7	11.7	59.9

Source: INEC (2014).

23 This paragraph draws directly on Korovkin (2005).

Box 2. Flower production and its effects on the rural poor in Ecuador

Flower production began in 1983 with the establishment of the Agroflora company, which focused on producing roses (Hernández et al., 2010). Flower exports collapsed in the crisis and recovered thereafter – real exports from cut flowers in 2004 were 75% higher than in 1999, and became Ecuador's third largest export earner after oil and bananas (BCE, 2003, cited in Sawers, 2005). Flower production is concentrated in three provinces that were the poorest in the country in 1990 (Sawers, 2005) and the industry had, by 2013, created 103,000 jobs (Conefrey 2015).

Flower production has had marked effects on the rural labour force: 'The development of an industry that employs nearly a quarter of the rural working age population (not counting multiplier effects, which could be as large as the direct employment) has had an extraordinary impact on the lives of the rural poor. The flower boom, has raised household incomes dramatically, increased labour force participation, and slowed or reversed rural-to-urban migration' (Sawers, 2005: n.p.).

Women comprise some 60% of the floriculture workforce; wages are several times higher than they can be earn in domestic work, often the only other waged work open to them (Korovkin, 2003, cited in Sawers, 2005). Evidence suggests this strengthened position in the labour market has led to women's greater bargaining power in their household (Newman et al., 2001). On the other hand, the growth of agro-exports has had some negative effects. The health and environmental effects have been well documented. Moreover, Korovkin (2005) argues that development of the industry prompted a rise in land prices, making it impossible for those working in the cut-flower industry to purchase land, and undermining existing support networks and community organisations (notably the peasant and indigenous movements that had given rise to an emerging rural civil society): 'it generates some limited economic opportunities for the rural poor, but it also increases their levels of insecurity and powerlessness, obstructing any meaningful progress in terms of long-term rural development' (Korovkin, 2005: 47).

petty trade and crafts (Hentschel and Waters, 2001: 35). As noted, the census data show a decline in shareholding and a rise in wage earning over the 2000s – one new source of employment in rural areas was the cultivation of cut flowers, particularly roses, for export (Box 2).

Social security and labour-market reforms

Changes in the labour market and in the structure of the economy were accompanied by reforms in labour and social security. Ecuador has a social security scheme only for formal employees. In 1998, 22% of Ecuadorians were part of the public social security system, but only 17% of those were from households in the bottom quintile. By 2006, these figures decreased to 18% and 13%, respectively. The low coverage was a result of the high levels of informality and employers' non-compliance with the requirement to register workers for social security.

A variety of policies have been adopted since 2007 to increase the coverage of social security, which in 2014 reached 41% of the population. Coverage in the bottom quintile reached 23%, and in the top quintile, it reached 64% (INEC, 2015b). This included legislation, passed after a referendum in 2011, which made it illegal (and subject to imprisonment) for employers to fail to register their workers for social security, thus also enforcing the minimum wage policy. Further, these policies banned outsourcing, hiring by the hour, and other exploitative forms of labour; labour inspections also increased significantly. Early evaluations of these interventions show that they are having a positive and significant effect on compliance (World Bank, 2012). From 2008 to 2011, the number of workers registered for social security doubled and it increased 81% between 2007 and 2013.

Inspections have focused in particular on domestic workers – their registration for social security increased from 10% in 2007 to 33% in 2013. In addition, domestic workers' wages were raised to the minimum wage in 2010. Initially these changes caused a drop in domestic labour, but the number of jobs had recovered by 2013, although domestic workers report working fewer hours (World Bank, 2014). Working women from the poorest households have been the main beneficiaries of these interventions.

Since 2007, the government has had an active minimum wage policy. The National Council of Salaries (CONADES) sets a minimum wage, which acts as a floor for all wages in different sectors, which are set by special commissions (Canelas, 2014). The minimum wage is high compared to international standards and to labour productivity (World Bank, 2014). The 2008 Constitution commits the government to revising the minimum wage annually, and in so doing, aiming to reach a '*salario digno*' or decent wage based on permitting an average family to acquire the minimum basket of goods. The decent wage has been calculated since 2007, and also serves as a guideline for adjusting the legal minimum wage. The gap between actual salaries and the theoretical *salario digno* has reduced over the last few years. In 2014, the minimum wage was $340 per month, while the decent wage was $390 per month. Moreover, paying its workers above the decent wage threshold is a requirement for any company that reports a net profit. Clearly, this policy directly benefits only those in the formal economy.

A recent study finds that the minimum wage had no dampening effect on the creation of formal employment and little effect on average (Canelas, 2014). At the same time, the evidence suggests a sustained increase in wages for Ecuador's workforce, particularly for its poorest sectors (Figure 10).

In the LAC context, wages in Ecuador also performed well. Brambilla et al. (2015) analyse the evolution of real wages in eight Latin American countries since the early 2000s. In 1998/2001, the monthly wage in Ecuador was $409 (2005 PPP), near the bottom of the ranking. It had increased 22% by 2002/2005 (and was one of two countries to show a wage increase in this period), and was 35% higher than its 1998/2001 rate by 2006/2009. The wages of poor workers rose by 46% over the longer period – higher than in any of the other seven countries. The authors find that employees benefited more than the self-employed and entrepreneurs, and that the largest increases in earnings were in manufacturing and services.

Although interviewees agreed that the labour-market policies have played an important role in reducing poverty, they expressed concerns about their possible negative impacts. Now the minimum wage is higher than labour productivity, this may render the labour market more rigid and reduce job opportunities; furthermore, the policy may become irrelevant if it is too difficult for companies to comply (World Bank, 2014). Moreover, the fact that wages are higher than productivity may limit innovation, and the creation of new products and services. As mentioned earlier, a country that does not have its own currency requires higher productivity than countries that do.

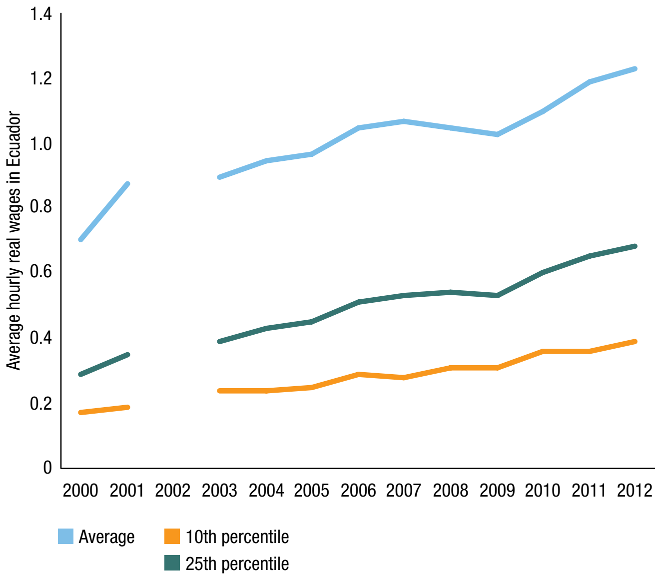
International migration

International migration has shaped the employment prospects of a large number of Ecuadorians since the early 1980s, and provided a sizeable inflow of remittances. An estimated 10–15% of the population migrated overseas, especially following the debt crisis of the early 1980s and the crisis nearly 20 years later (Jokisch, 2014). Remittances have been (and are) the country's second largest source of income after oil. They have had important effects for recipient households, but appear to have slightly increased income inequality.

During the 1970s, most migrants were young men, and from rural communities in two provinces of the country. They typically settled in the USA. The crisis of the late 1990s triggered 'an unprecedented wave of international migration' (Bertoli and Marchetta, 2014: 3). Approximately 725,000 Ecuadorians left the country between 1998 and 2004,[24] mostly for Spain – where few had lived previously – or the USA.

A notable feature of migration to Spain (and also Italy) is its gendered aspect. Most migrants to these countries were women – currently 52% of Ecuadorians in Spain and 59% in Italy – and were performing domestic work (cleaning and/or caring). Male migrants typically worked in construction, agriculture and services. With

Figure 10. Evolution of average hourly real wages in Ecuador, 2000–2012



Source: Based on ENEMDU estimates, cited in Canelas (2014: 9, Table 1).

the economic upturn in Ecuador, there has been some limited return migration. At present, an estimated 1.5 to 2 million Ecuadorians live abroad – mostly in Spain (around 450,000) and the USA (around 425,000) (Jokisch, 2014). Migration altered the national labour market by reducing the economically active population, another aspect that may have affected the improvement of labour market indicators.

The value of remittances peaked at $3.3 billion in 2007 and has been steady at about $2.5 billion yearly since 2010. As of 2012, remittances contributed approximately 3% to GDP (World Development Indicators, 2015). Their impact has varied. Before the late 1990s, 25% of households reported receiving remittances in the main migrant-sending provinces (Jokisch, 2014). Later migration waves were more geographically and socioeconomically diverse as migration became a national phenomenon.

More privileged households were able to send members overseas, particularly following the crisis of the late 1990s. Survey data from 2005 show that these migrant-sending households tended to be urban, smaller, more educated and have a lower dependency ratio (Bertoli and Marchetta, 2014). The participation of poor households, in turn, was hindered by the high costs of migration. The money that migrants remitted proved important income for recipient households, estimated at one in seven in the 2010 census. Bertoli and Marchetta (2014) find that post-1999 crisis migration in Ecuador reduced the incidence of poverty

24 Computed from data in Vasco (2007: 51, Figure 5.3).

‘We have a strong president, proposing a new model under positive conditions: an ambitious constitution, total majority in the legislative and robust economy, unlike any period before’ – Researcher

among recipient households by 57–59%. According to the 2006 ECV, most remittances were spent on food (44%) and education (18%) (Olivié et al. 2008). Other studies link remittances to an improvement in schooling and reduction in child labour – see Acosta et al. (2007) and Calero et al. (2008). Research on the impact of remittances on poverty at a national level finds that it is positive but weak (Acosta et al. 2007).

3.3 Radical political change towards strong government and redistribution

The case of Ecuador portrays a virtuous cycle between stability and growth, fostered by the international context of higher oil prices. This improved economic situation contributed to poverty reduction, mediated in large part through the labour market. Ecuador’s success in reducing poverty was also largely driven by a number of political factors and ensuing policy decisions. In particular, in 2007 the country experienced a radical political shift with the election of President Rafael Correa. This section discusses the main aspects of the new political regime that have contributed to the country’s success in reducing poverty.

From political instability to continuity and a new way of conducting politics

The first significant change in the political regime is the continuity of the Correa government (he has been in power for two terms and started a third and final term in 2013) and the relative political stability that has underpinned it. Indeed, interviewees for this case study remarked on the importance of political stability as a necessary condition for policy changes.[25] This stability is particularly relevant because it contrasts with the extreme political instability that had characterised the previous decade and had prevented any significant reform.

In 1996, Abdala Bucaram took office as president of Ecuador for six months, after which he was forced out of office. This followed heavy protests connected with corruption and embezzlement scandals, and popular dissatisfaction with increasing petrol prices as well as with the president’s extravagant populist style. After Bucaram went into exile, the vice president and the president of Congress battled for leadership. Rosalia Arteaga, Ecuador’s first female vice president, was sworn in for just two days, after which the Congress changed its decision and appointed Fabián Alarcón, the president of the Congress. His presidency lacked the political support for any significant reform, except for the drafting and approval of a new Constitution in 1998.

Elections in 1998 brought to power Jamil Mahuad, who was forced to resign in 2000 after a military coup and social protests (following the adoption of dollarisation in 2000). The vice president Gustavo Noboa assumed power and held office for three years. During his presidency, dollarisation was fully implemented. The 2003 presidential elections were won by Lucio Gutiérrez, who had been involved in the military coup in 2000. He was deposed after two years. Struggles with indigenous movements and an attempt to manipulate the judicial system sparked a resurgence of political unrest, which ended in him fleeing the country and later being imprisoned on charges of corruption. His vice president, Alfredo Palacio, took power for a little under two years and in the next elections Rafael Vicente Correa Delgado was elected.

Thus, between 1996 and 2006, none of the elected presidents was able to complete their term. Three key characteristics of the political system explain this instability: the limited capacity of different political parties and coalitions to collaborate, the presence of political actors with the power to veto agreements and a highly fragmented legislative branch (Mejía Acosta, 2009). Presidential instability led to very unstable governments, since ministers were constantly changing and no long-term policies were implemented.

This historical trend stands in contrast to the period following the election of Rafael Correa in 2006 (he assumed the post in 2007). Since then, he has won three consecutive elections, each time gaining more political power in the legislature. His political strategy has focused on strengthening the links between the government and the citizens while trying to bypass political negotiations.

This strategy was reflected in the electoral promise to transform the country through a Citizens’ Revolution whereby new institutions would be created to place citizens at the centre of policy-making and enhance their participation in political and cultural life. Indeed, Correa was elected in a context of political unrest and without significant previous experience in electoral politics or party affiliation, as he had previously only been Minister of Finance for four months in 2005 (Conaghan and De la Torre, 2008). His electoral campaign was led by the Alianza Patria Altiva y Soberana (PAIS) (Proud and Sovereign Nation Alliance – PAIS also means country),

25 All interviewees agreed on the importance of both economic and political stability to explain the reduction in poverty, but while some believed that the reduction was primarily driven by the economic growth led by oil exports, others gave primacy to the government’s policies.

a political movement that linked diverse political actors dissatisfied with the status quo, including social and indigenous movements that had played an important role in bringing down previous governments. In his electoral campaign, he opposed the traditional political establishment by promising to extend democratic participation beyond institutional politics. Another cornerstone of his campaign was the 're-founding' of the country as a pluri-national state, to be marked by the drafting of a new Constitution (adopted in 2008).

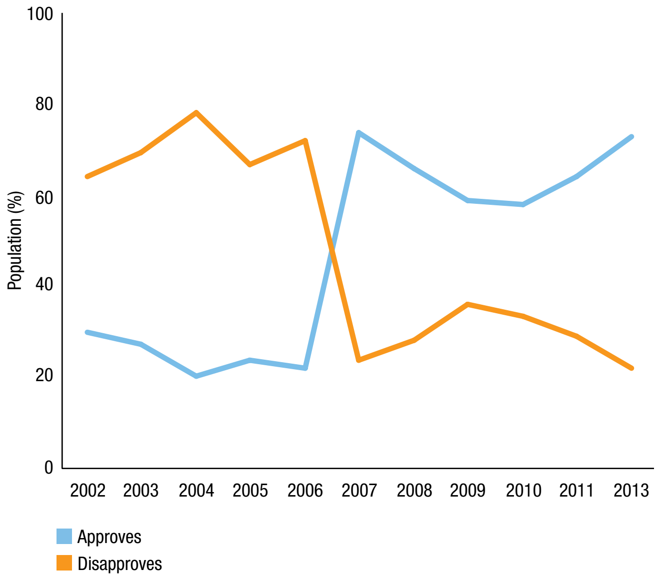
The 2008 Constitution established a number of mechanisms by which citizens can actively participate in the exercise of their rights. For example, mechanisms of participatory planning were created for the preparation of the *Plan Nacional Para el Buen Vivir 2009–2013*) (the National Plan for Living Well 2009–2013), and 4,000 citizens representing different socioeconomic and ethnic backgrounds and ages were consulted (Hevia-Pacheco and Vergara-Camus, 2013).

The implementation of these mechanisms has, however, faded over time (ibid.) and there has been little or no use of the institutions created to enable the participation of civil society in planning. Rather, they have been replaced by populist tendencies marked by frequent electoral consultation and the focus of both rhetoric and policies on social policies. Several analysts have argued that the practice of the government often contradicts its discourse and plans, especially the *Plan Nacional Para el Buen Vivir* (ibid.). CONAIE (Ecuador's National Indigenous Confederation) and other indigenous groups have left Correa's coalition government, criticising its lack of commitment to implementing pluri-national and intercultural measures in political discourse and practice (Radcliffe, 2012).

Overall, under Correa, the direct link between the government and the citizens has been pursued less through citizens' direct involvement in planning and politics, and more through an extreme plebiscitary presidency (Conaghan and de la Torre, 2008). As a result, the government is in constant campaign mode and gains and maintains political power through public support. It requires maintaining high levels of government acceptance by the electorate (ibid.).

Correa has projected himself as a strong and likable character, with an attitude of protection, support and willingness to communicate directly with his constituency (Espinosa Andrade, 2011). Another essential element of Correa's plebiscitary presidency has been frequent electoral consultations. Between 2006 and 2013, Ecuadorians voted five times, three times in electoral processes and twice in referenda to approve the Constitution of 2008 and then to amend it. In the 2009 elections, Correa gained a significant majority in the legislative (47% of votes) and strengthened his position even further during the 2013 elections, gaining 76% of votes in the legislature. Public opinion polls confirm this high rate of support. Between 2002 and 2006, 25% of the population approved of the government (Figure 11); between 2007 and 2013, the government of Rafael Correa has had an average approval rate of 66% (Latinobarómetro survey).

Figure 11. Share of the Ecuadorian population who approve or disapprove of the country's government, 2002–2013



Source: Authors' analysis based on Latinobarometro data.
Note: Up to 9% of the population replied 'don't know' or refused to answer in a given year. These answers are not included.

Shift towards redistributive social policies

Correa's political regime was also characterised by a strong emphasis on redistributive social policies, the outcome of the combination of three interconnected factors: the influence of civil society groups in drafting the 2008 Constitution, Correa's personal beliefs and his populist political strategy.

Civil society's push for change and the Buen Vivir paradigm

Civil society groups (including indigenous, environmental and women's movements) played an important role in bringing Correa to power as well as in shaping his electoral agenda based on a *Citizens' Revolution*. Representatives of various social movements took part in drafting the new constitution, ensuring the incorporation of the principle of *Buen Vivir* as a guiding principle for the re-foundation of the state and its development strategy (Hevia-Pacheco and Vergara-Camus, 2013). The importance of civil society involvement in drafting the 2008 Constitution as a key determinant of Ecuador's ability to shift priorities towards social policies was also recognised in the interviews carried out for this study.

Buen Vivir is the Spanish translation of the indigenous concept of '*sumak kawsay*', which indicates the achievement of a full life through the full recognition of cultural, economic and social diversity, and has been at the core of the indigenous social movement agendas since the 1990s (Radcliffe, 2012). According to the principle of *Buen Vivir*, the state's purpose is to fulfil human beings' material and spiritual needs in harmony with their natural environment, prioritising quality of life over wealth, income or profit (National Bureau of Planning of Ecuador, 2009, cited in Yánez, 2014). It delineates a conceptual framework for policy-making based on justice and the distribution of resources as well as fuller knowledge of ethnic diversity and the historic dispossession of indigenous peoples (Radcliffe, 2012).

The *Plan Nacional Para el Buen Vivir 2009–2013* was based on three pillars: economic, political and environmental. At the economic level, the government outlined its aims to foster sustainable economic growth through selective import substitution, diversification and redistribution in key productive sectors. The political pillar is the establishment of a system of decentralised management for territorial planning and capacity building. At the environmental level, it aims to guarantee the sustainable exploitation and protection of natural resources (Hevia-Pacheco and Vergara-Camus, 2013).

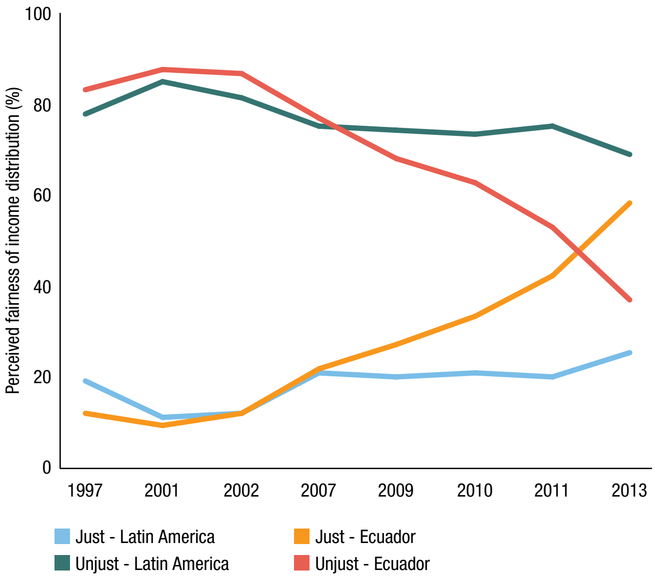
Overall, *Buen Vivir* provided the conceptual basis for the emphasis on social investment and the inclusion of historically excluded groups. The traction for participatory democracy that characterised the early days of the constitutional process has been lost, however – at least in the government – and the gap between the rhetoric and implementation of *Buen Vivir* has been widening. Furthermore, the redistributive policies that have been implemented relate mainly to the sphere of social services, while the economic and the environmental areas – where structural change would demand redistribution of assets and reforms in the management of productive resources – have not been significantly addressed.

At the same time, allocation of public spending on social policies increased significantly after 2007, with a notable effect on poverty reduction (see Section 3.5). While *Buen Vivir* may have provided the discourse for the shift towards redistributive policies, their implementation was made possible by Correa's strong political will, which was in turn a function of his personal beliefs and populist political strategy.

Political will for redistributive social policies: political convenience and personal beliefs

It is difficult to separate political interest and opportunism from the government's genuine commitment to social policies and redistribution. Correa had expressed his ideas on the importance of pro-poor policies well before becoming president. For example, in an essay prepared for the United Nations Development Programme (UNDP) in 2004, he argued in favour of some of the policies that he later implemented as president. In particular, he stressed the importance of 'social goals as ends by themselves', and of a reconnection of the

Figure 12. Perceived fairness of income distribution in Ecuador and Latin America, 1997–2013



Source: Authors' elaboration based on Latinobarometro data.

macroeconomic decisions with the social protection policy and strengthening of the state (Correa, 2004).

At the same time, it is evident that the strong focus on social policy has been an essential element of Correa's strategy to maintain power and public support in a context where these policies could yield significant political returns.

The focus on social policies led to three lines of action: (a) an increase in public expenditure on social protection, health and education; (b) an effort to improve the quality of public services; and (c) an increase in the presence of the state by spreading the coverage of social services beyond the main cities. As discussed below, all of these strategies had a substantial positive impact on the reduction of poverty and inequality. They also significantly contributed to maintaining high levels of public support for the government and its redistributive policies. Public opinion polls point to the shift that occurred in this period (Figure 12). Between 1997 and 2002, only 11% of Ecuadorians thought that the income distribution was fair, similar to the average for Latin America. This trend began to change in 2007, and the share believing it was fair reached 58% in 2013, far above the regional average. The same survey also shows an increase in satisfaction with public services by 13 points between 2009 and 2011. In 2009, 55% of the sample was satisfied, which by 2011 had increased to 68%. For public education and health services specifically, satisfaction rates in 2011 were 73% and 70% respectively.

Political will, a strong government with public support and an influx of resources made it possible to embark on social investment and redistributive policies which had been impossible in Ecuador in the previous 15 years. This combination of political (and economic) factors that enabled this achievement may be less effective or not sustainable under the government that will be elected in 2017. This issue is further discussed in Section 4.

Radical measures to create fiscal space

Correa's commitment to redistribution was also reflected in the measures adopted to raise the resources necessary to implement the social policies discussed above. The expansion in social spending was achieved by 'making the cake bigger' – in other words, increasing the resources available – and in having more power over how to divide it. These radical measures contrasted with the conservative fiscal stance that had characterised the 2000–2006 period.

Measures to increase available public resources

First, additional public resources were made available through reforms in the management of oil revenues. In 2006, the government of Alfredo Palacio established a new windfall tax, under which all additional revenue from any increase in the price of oil over the contracted price would be split equally between the government and the oil companies. In 2007, under Correa's government, this tax was first changed to a 99-1 distribution in favour of the government, and then finally set at 70-30 in 2008. This decision clearly reflected the government's intention to strengthen the role of the state in the economy.

The new tax opened a debate on a more profound renegotiation of contracts between the oil companies and the state. This resulted in new contracts with ten oil companies, while seven rejected the new contracts and left the country (Herrera et al., 2012). The fields left by private companies were taken over by the national oil company. Initially, these changes had a negative effect on oil production, which fell from 195 million barrels in 2006 to 177 million in 2009. Production started to recover only after new contracts were finalised in 2011 (Herrera and Jarrín, 2014). Revenues increased from 7.8% of GDP in 2006 to 20% in 2011, when oil was priced at $99 a barrel. In the following years the revenues fell with the price adjustment, and by 2014 they represented 11% of GDP.

The second source of additional public revenues was taxation. Between 1996 and 2012, tax revenues in Ecuador increased from 5.6% to 14.5% of GDP. While the value-added tax (VAT) as a share of GDP remained stable throughout the 2000s, income tax has increased from 1.5% of GDP to 4.2% (Table 7). In particular, reforms adopted in 2007 established an overseas remittance tax, to retain dollars within the economy, a progressive inheritance tax, and tax deductions for household spending on health, education, food and housing (Castro et al., 2014). An effort was also made to improve the capacity and technical skills of the country's revenue office. Currently, Ecuador has the fourth highest tax burden in Latin America, following Argentina, Brazil and Uruguay. As direct taxation (e.g. on income and profits) tends to be more progressive than indirect taxation (e.g. VAT), these reforms contributed to the decline in inequality described in Section 2.

Table 7. Main taxes as an average percentage of GDP

	1996–2000	2001–2006	2007–2012
VAT	3.8	6.2	6.2
Tax on special consumption	0.5	0.8	0.9
Income tax	1.5	2.8	4.2
Other	6.1	5.5	7.6

Finally, additional resources were generated by restructuring the public debt. By 2006, public debt represented 22% of GDP, the lowest since the default in 1999. In 2007, however, Correa's government initiated a public audit of the foreign debt. Correa had been a strong critic of debt acquisition and proposed an audit to determine if this debt was legitimate. In 2008, a commission presented a report that found various irregularities in the mechanisms by which the debt had been acquired. As a consequence, the government stopped paying its bonds in November 2008. In 2009, the government completed a buyback of 91% of the bonds at $0.35 on the dollar. This allowed it to retire a third of its foreign debt with a significant discount and reduce the debt to 14% of GDP, a new historical low. In the short term this strategy succeeded in reducing the country's debt, but worsened Ecuador's already poor reputation in international markets, further reducing its ability to obtain new credit at competitive rates.

All these strategies resulted in expansion of the state. Between 2007 and 2008 the non-financial public sector had increased its total income from 30% to 41% of GDP, which meant an increase of $7,000 million dollars in just one year.

Reforms in the management of public resources

In this period, reforms were also introduced to modify the management of resources. In particular, to gain control over the increased resources, the government sought to change the mechanisms by which revenues, primarily oil revenues, were distributed. The president had limited power over the national budget, only 6% of which could be redirected to new policies. Most of the budget was earmarked for specific expenditure, salaries for a large bureaucracy, the repayment of the foreign debt, and the oil derivatives subsidies (Cueva, 2007).[26]

26 Ecuador has subsidies for the domestic consumption of petrol, diesel and Liquefied Petroleum Gas (LPG), which are applied even when domestic production of these derivatives does not fulfil demand and they need to be imported.

This complicated management of public revenues resulted from historical political factors. Since the 1970s, with the first oil boom, resources were earmarked to different constituencies that could leverage power to pass legislation that would be directly financed by oil revenues. These constituencies included the police, the military, local governments, universities and social institutions among others. In total, more than 100 institutions benefited from earmarked resources (Grupo FARO, 2008). As a result, the budgetary process was relatively meaningless since most of the finance was pre-allocated.

Until 2006, no government had had sufficient political power to modify this process. Starting in 2007, however, the Correa government introduced reforms to increase the executive's power over the national budget. In 2008, it enacted a law that eliminated all earmarked expenditure as well as all oil funds.

Oil funds had been an important component of Ecuador's fiscal policy management strategy. Indeed, for a country as dependent on oil revenues, a key objective of fiscal policy is to manage these inflows and the possible associated shocks. To do this, various special funds had been created. In 1998, the Oil Stabilisation Fund was created to manage oil revenue when the price exceeded the budgeted price. By 1998, however, prices were already declining internationally and continuously falling short of the budgeted price, so in practice the Fund was unable to generate a reserve during 1998 and 1999. In 2002, an additional fund was created to house extraordinary earnings from oil exports and earmarked 70% of them to repay the foreign debt. The rest (30%) was earmarked for health and education. In 2005, when Rafael Correa became Minister of Finance, this fund was modified so that 35% would repay the foreign debt, and the remaining 65% was allocated to spending in education, health, infrastructure and science and technology. In 2006, the government of Alfredo Palacio cancelled one of its main oil contracts with the company Occidental Petroleum and took over production in these fields. It also created a fund to manage the additional revenue generated by this operation. By 2007, all these funds amounted to a total $7,600 million. Of these, $5,600 million were used: 33% to compensate for price shocks affecting the national budget, 23% to pay the foreign debt and services, and 12% on health and education. The remaining $2,000 million were saved.

When Correa eliminated the funds, these $2,000 million in savings became available (Grupo FARO, 2010). These reserves, representing around 3% of GDP, entered the budget in 2008. In addition, following the abolition of earmarking, these resources could be included in normal budgetary planning processes. To complete this reform, the government passed a new fiscal and planning law in 2010. This linked the budget to planning exercises led by the National Planning Secretariat, which is responsible for coordinating and monitoring the effective use of public resources. The new law also increased the power of the executive in the budgetary process by making it more difficult for the legislative branch to change its proposals. Furthermore, fiscal regulations were minimised, giving the government more space to adjust the budget during the year, and setting a new limit for the public debt to 40% of GDP.

In contrast with the conservative fiscal policy and macroeconomic management of the 2000–2006 period, Correa's administration adopted quite radical measures for the management of public resources (see Table 8). These measures underscore the government's ideology and political will regarding redistribution. With more resources and greater flexibility, the government was able to increase expenditure on the social sectors and on infrastructure projects.

These reforms would have been difficult to implement if the government of Rafael Correa had not had the control of the legislative and strong popular support. They also contain an authoritarian element, because the government's complete control of the budgetary process minimises the possibility of a public debate on the use of public resources and undermines democratic checks and balances. Further, as discussed earlier, the channelling of all revenues into current public expenditure – albeit for redistributive uses – undermined the state's savings capacity and its ability to manage the economy in a counter-cyclical manner.

3.4 Strengthening the social protection framework and social services for poor people

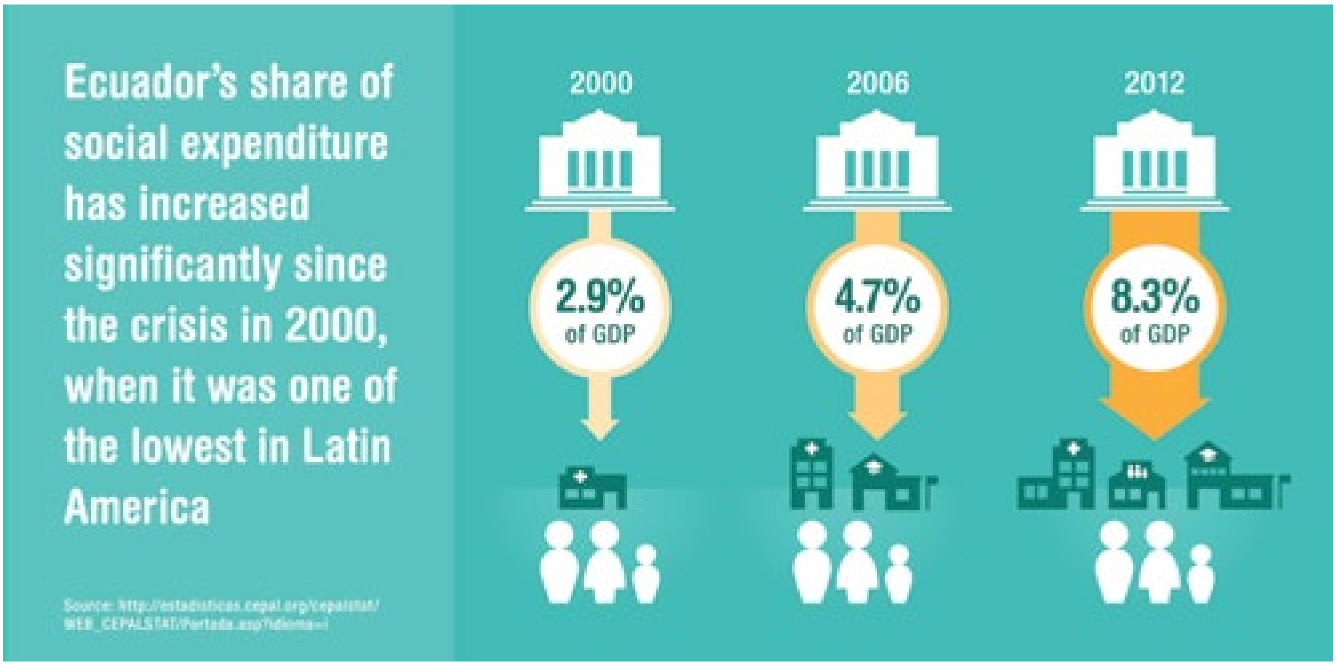
As discussed above, a conservative fiscal policy was adopted between 2000 and 2006 to recover from the economic crisis and achieve macroeconomic stability. This strategy had some

Table 8. Main fiscal reforms

Period	Reforms
1996–2006	• Creation of an independent Tax Agency (1997) • Creation of an Oil Stabilisation Fund (1998); in 2002, creation of a new fund to save oil revenue for specific purposes, including the payment of foreign debt • Increase of VAT from 10% to 12% (2000) • New fiscal law (2002) to introduce policies of 'fiscal responsibility' by limiting public spending and debt.
2007 onwards	• Eradication of all earmarked expenditure from tax and oil revenue • Elimination of all oil revenue funds and transfer of saved resources to the government budget • Creation of a windfall tax for oil revenue, and later renegotiation of contracts with private companies • New fiscal law (2010) that seeks to link government spending to public policy planning. It also minimises rules on expenditures and debt ceilings.

Sources: Cueva (2007); Grupo FARO (2010).

Figure 13: Social expenditure in Ecuador



significant costs (e.g. it limited public expenditure for social programmes) and it sparked opposition. After 2007, an expansive fiscal policy permitted new measures to expand the provision and improve the quality of public services (see below.)

Social expenditure increased considerably. Ecuador was traditionally among the countries with the lowest social expenditure in the region. In the period between 1996 and 2000, on average 3.6% of the GDP went to social expenditure. In 2000, the year of dollarisation, it fell to its lowest, at 2.9%, well below the regional average of 12.7% (Figure 13). Between 2001 and 2007, social expenditure increased to an average of 5.3% of GDP, compared with 14.5% in LAC. By 2012 it reached 8.3% of GDP, while the Latin American average was about 15.5%.* In per capita terms, social expenditure increased from $146 in 2006 to $297 in 2012 (CepalStat). It is worth noting that the increase that occurred between 2001–2007 and 2007–2012 in the context of similar GDP growth (4%), suggests that the government made a greater effort to redistribute the benefits of economic growth through social expenditure.

The shift in public finance had an impact on reducing poverty: as mentioned earlier, poverty reduction was driven by growth between 2000 and 2006, whereas redistribution (through fiscal policy) became the main factor from 2007. The following sections provide an overview of how additional spending in health, education and social protection benefited the poorest people and contributed to reducing poverty.

Strengthening the social protection framework

A key focus of government policy was social protection, which included the expansion of the cash-transfer programme that had been in place since 1998. The programme was originally designed to compensate poor families for the removal of universal subsidies on cooking fuel. Eventually, the subsidies were not removed, but the programme was intended to support people's capacity to survive the 1999 crisis. It was originally called the *Bono Solidario* (or Solidarity Grant) and was aimed at people in the bottom two quintiles with at least one of three characteristics: having children under 18 years old, being over the age of 65 years or having a disability. Mothers of children under the age of 18 originally received $15.10 a month, and the other two groups received $7.60. Initially the programme was self-targeted, and potential beneficiaries were asked to register through their local parish. The first programme was an emergency mechanism, with little effort to correct targeting errors or any conditionality. Later on it was reformulated to include a targeting process via a proxy means test.

The programme was not significantly reformed until five years later when, in 2003, it became the *Bono de Desarrollo Humano* (Human Development Grant – BDH). In theory, the programme was a cash transfer made conditional on children's school attendance and health checks. This conditionality was never applied, however, as no formal monitoring system was established. Rather, a campaign promoted school attendance and child health checks. In the case of senior citizens and people with disabilities, the programme became an unconditional pension, although targeting was improved through a registry and means-testing mechanism. Between 1998 and 2006 the programme reached on average 1.2 million beneficiaries (of a population of about 14.2 million).

In 2007, the government increased the allowance to $30 per month for all targeted groups, and in 2009, to $35. This increase was necessary but controversial, since the amount coincides with the number of the government's party PAIS on the ballot sheet (35). In 2012, during the electoral campaign, the amount was increased again to $50 monthly.[27] Between 2007 and 2014, the programme reached on average 1.6 million beneficiaries. In 2015, the number was reduced to 1.1 million following a new means-testing survey and the targeting requirements were adjusted. The average cost of the BDH has been between 1% and 1.4% of GDP (authors' calculations).

As the programme evolved, its role in Ecuador's social protection framework became clearer. Allowances for households with children are closest to meeting the definition of a conditional cash transfer (CTT) programme, with the transfer expected to finish when children reach the age of majority (18 years) or if the household significantly improves its economic conditions. Old-age pensions and stipends for people with disabilities are expected to become permanent.

For those in the informal economy, the BDH has become a major element of social protection, as it is linked to other benefits such as an emergency grant (in the case of a natural disaster) and life insurance for family members that covers funeral costs. In addition to the BDH, there is a new grant, the 'Bono Joaquín Gallegos Lara' for the family carers of people with severe disabilities, which reaches 20,000 people.

Numerous studies have found that the BDH programme has achieved significant positive effects among the poorest households (Edmonds and Schady, 2009; González-Rozada et al., 2011; León and Younger, 2007; Oosterbeek et al., 2008; Paxson and Schady, 2010). For example, the programme increased school enrolment of children in poorest quintile by 10% (Oosterbeek et al., 2008). This is consistent with evaluations that found a significant reduction in child labour among the programme beneficiaries (Edmonds and Schady, 2009). An evaluation carried out between 2004 and 2005, before the significant increase in expenditure on education, found that the BDH programme had no significant impact on students' test scores, suggesting a limited impact, in the absence of other policies, to improve the quality of education (Ponce and Bedi, 2010). The BDH programme was also found to have a positive, though modest, effect on the development of the poorest children and their nutritional status (independent of the general impact on the household), when the transfer was set at $15, suggesting that benefits may well have increased since (León and Younger, 2007; Paxson and Schady, 2010). Further, there is evidence to suggest that the programme increases food consumption in beneficiary households, especially when the recipient is the mother, suggesting that paying the transfers to mothers could have an additional positive impact (Schady and Rosero, 2008).

There is some evidence that the programme has had a negative impact on the labour supply by increasing the duration of unemployment and reducing the likelihood that mothers receiving a benefit will seek formal employment (González-Rozada et al., 2011). These effects may occur only when the transfer reaches a certain threshold amount (Mideros and O'Donoghue, 2014). The source of this negative effect is probably that in order to qualify for the BDH, households may not be part of the national social security scheme, which creates a strong incentive for families in the BDH to stay in the informal sector. Despite the restriction being lifted in 2009, many people remained fearful that they would lose access to the BDH if they entered the formal labour market. After the new rules regarding the proxy means tests, workers who are formally employed are no longer eligible for the BDH.

Overall, evidence suggests that the BDH programme has achieved a positive impact, especially among the poorest households. These outcomes do not seem so significant for the households closer to the eligibility threshold. Key informants interviewed for this study agreed in general on the importance of the cash-transfer programme in reducing poverty, especially extreme poverty. Some interviewees regarded cash transfers as a stepping-stone to more significant change in Ecuador's social protection system, while others saw it as an impediment to labour market functioning. This debate reflects beliefs about priorities, the sequencing of policies and the possible role of social protection.

Improvement in public services with focus on health and education for the poorest households

As mentioned earlier, redistribution was a major driver of poverty reduction between 2007 and 2012. In this period, redistributive policies were aimed at increasing health spending and service coverage for all population groups.

The Constitution states that at least 6% of GDP should be spent on primary and secondary education and 4% on health. Moreover, spending on health and education should always exceed repayment of the foreign debt. Accordingly, spending on primary and secondary education increased from 3% of GDP ($1,383 million) in 2007 to 5.2% of GDP ($3,397 million) in 2011, while health spending rose from 1.2% GDP, the lowest in Latin America ($606m – about $500 per capita), in 2007 to 2.4% ($1,611 million, corresponding to $692 per capita) in 2011 (Ministry of Finance data).

One of the main uses of the increased funding was to make services free at the point of delivery and to identify other measures to improve access to them. In education, measures included (a) doubling the coverage of free meals at schools from 1.3 million beneficiaries in 2007 to 2.1

27 This amount is just below the individual poverty line (now equivalent to $56), although the money is not made to individuals but to households regardless of their size. The official change in the value of the transfer was introduced in January 2013.

million in 2013; (b) abolishing all tuition and voluntary contributions to public schools in 2007; and (c) launching a free textbook and uniform programme in 2007 (Araujo and Bramwell, 2015). In the health sector, free access was expanded to include preventive care: preventive medical consultations had increased by 21% between 2000 and 2005, and by 130% from 2005 to 2011 (Ministerio de Salud Pública, 2011). This increased use of health services was accompanied by an increase in the number of doctors, from 17.2 per 10,000 persons in 2000 to 21.4 in 2010 (ibid.). When the government of Rafael Correa came to power, one of the first actions was to use the newly available resources to employ 2,800 health professionals to work in the poorest regions of the country.

Other efforts were also made to increase the presence of the state and the coverage of services, especially in the poorest regions. To achieve this, the government pursued the process of fiscal deconcentration that had started in the mid-1990s. This process has enabled lower levels of administration (i.e. districts and circuits) to receive larger shares of public expenditure with the power to manage them, reducing the bias in allocation of resources towards larger cities. Before the reform, services were administered at the provincial level, which resulted in better provision in the provincial capitals than the rest of the province. Following the reform, services have been organised in smaller units. Districts serve approximately 90,000 inhabitants and circuits 11,000. The aim is to enable each of the 1,134 circuits to provide all state social services, so that people should no longer need to travel to bigger cities. For this purpose, the construction of new schools, hospitals and health centres has focused on previously unserved districts and circuits. As a result, for example, the proportion of parishes (or counties) without health personnel fell from 14% in 2001 to 8% in 2010 (Senplades, 2013).

Overall, there has been substantial change in the public sector in Ecuador. Social policy consisting of small-scale targeted social programmes has evolved into a wider and more universal strategy with a clear objective. The benefits for the poorest households have been substantial, as demonstrated by improvements in various health and education indicators.

For example, primary education enrolment, which had fallen from 92.2% in 1999 to 89.4% in 2006, reached 93% in 2014. A similar trend occurred in secondary education, where enrolment increased from 65.9% in 2006 to 81% in 2014 (INEC, 2014). There was also an improvement in the quality of education as measured by the UNESCO and TERCE tests – student learning outcomes were below the regional average in 2006, but were comparable by 2013 (UNESCO, 2014). Similarly, the coverage of public health insurance dipped from 19.2% in 1999 to 18.4% in 2006 before rising to 40.7% in 2014.

The poorest people benefited substantially from investments in these sectors. In the education sector, the gap between the richest and the poorest in terms of school attendance fell significantly. In the case of basic education, the gap dropped from 21% in 1999 to 11% in 2006 and to 2.5% in 2014. For secondary education, the reduction is even more significant: 67% in 1999, 48% in 2006 and 22% in 2014. A similar trend is observed with respect to skilled birth attendance. The gap between richest and poorest reduced from 50% in 1999 to 31% in 2006 and 18% in 2014 (INEC, 2014a). The gap in attendance in basic schooling between rural and urban areas also decreased: in 2006, the school attendance rate was 4.3% lower in the rural sector. By 2014, this gap had disappeared, and in fact attendance was 0.7% higher in the rural areas than in urban centres.

In this section, we have argued that four factors are critical to understanding the reduction of extreme poverty in Ecuador. First, **economic recovery** was **accompanied by a period of macroeconomic stability**, enabled by a favourable international context (high oil prices) alongside tough decisions in monetary policy and fiscal policy. In particular, the country adopted the US dollar as its national currency in 2000 to help stabilise the economy, together with a conservative fiscal policy (until 2006). The high price of oil also guaranteed significant revenues. The benefits of economic growth were transmitted to the poor through increases in employment and real wages as well as in social spending and cash-transfer programmes. The second key factors were, therefore, the **changes in the labour market**, in particular an increase in domestic demand for goods and services, a shift away from agriculture and significant international migration. The effects included a decline in unemployment and a rise in real wages – particularly for the poorest sectors of the population – and large inflows of remittances. Third, the country experienced **radical political change towards a regime characterised by continuity, concentration of power and political will for redistribution**, following the election of President Rafael Correa in 2007. The new political regime was characterised by the adoption of radical measures to create fiscal space for social expenditure as well as inclusive social policies. Fourth, the increased resources for social spending enabled substantial **investment in health, education and social protection**, which were particularly beneficial for the poorest people: the *Bono de Desarrollo Humano* had positive effects in terms of child nutrition, household consumption and school enrolment rates; people living in poverty experienced improved human capital (measured by health and education outcomes), and the provision of many services free of charge had a positive effect on the income of the poorest people by reducing the need for out-of-pocket expenditure. Nevertheless, poverty, inequality and regional disparities persist in Ecuador, and the evolving economic and political context poses significant challenges to the country's ability to achieve further progress in eradicating poverty eradication and improving human development. We now turn to a discussion of these challenges.

4. What are the challenges?

Ecuador. Photo: © Marcio Ramalho.

Ecuador faces the challenge of advancing and deepening the progress it has achieved in the context of changing domestic and international circumstances. Further reduction of poverty will call for greater attention to be paid to sectors that have not fully shared in the benefits of growth. Equally, future progress will require economic diversification, accompanied by a reduced dependence on oil exports and the creation of jobs for skilled and unskilled workers. In terms of macroeconomic management, the current and future governments will have to achieve better allocation of resources to allow for redistributive public spending as well as prudent fiscal management and the saving of resources for future generations. The participation of civil society will be key to guarantee that policy-making is consistent with all aspects of the '*Buen Vivir*' paradigm – the economy, the environment and human development.

4.1 Tackling persisting poverty

Despite progress, poverty and deprivation persist in Ecuador, and are especially acute among certain population groups, especially those living in rural areas and in particular regions and among the Afro-Ecuadorian and indigenous populations. Addressing the barriers that have constrained these sectors from benefiting more fully from economic growth will be vital to reduce poverty further and to realise a more equitable society that is consistent with the ethos of '*Buen Vivir*'. Efforts to reduce poverty will have to focus on reducing the gaps between rural and urban areas, between regions and between ethnic groups. In this section, because we are comparing different population groups in Ecuador, our discussion is focused on the national poverty line.

Rural and urban gap

Poverty is still overwhelmingly a rural phenomenon – in 2014, nearly 50% of the rural population was living in poverty, compared with about 14% of the urban population. The gap in income poverty between rural and urban areas is pronounced, exceeding 30 percentage points over the last decade, though this appears to have fallen somewhat (from 37 to 32 percentage points) as poverty in rural areas has fallen more than in urban areas (Table 9).[28] It is, however, noticeable that chronic poverty has been three times as high in rural areas as urban areas over the whole of the 1995–2014 period – reaching a low of 2.4 times higher during the 1999 crisis – and a high of 3.6 in 2014.[29]

Gaps in other indicators of living standards are less marked. In particular, both the Census and data from the 2014 ECV show that the gap in access to basic education (grades 1–10) for urban and rural areas was virtually eliminated between 2006 and 2014 (it was 93% in 2014) and that the gap in access to 'middle education' (grades 11–13) fell. The gap in infant mortality remains pronounced (30% higher in rural than urban areas) but fell from 1990 to 2010, from a difference of 30 to 10 deaths per 1,000 live births.

Table 9. Poverty in urban and rural areas, 2006 and 2014 (%)

	2006	2014	Difference
National	38.3	25.8	-12.5
Urban	24.9	15.5	-9.4
Rural	61.5	47.3	-14.2
Urban–rural gap	*36.6*	*31.8*	

Source: INEC (2006; 2014c).

Regional variation

Ecuador exhibits substantial subnational variation in the incidence of poverty – with the biggest deprivations in rural areas in the Amazon (Amazonía) and the Coast (la Costa).[30] Poverty declined in all major cities and regions over the 2000s (see Table 10) – but remains significantly higher in the Amazon region than elsewhere (nearly twice as high as in the Coast and Sierra regions) as a consequence of the lack of (or limited) public infrastructure, adequate housing, health services, agricultural cultivation and diversification of productive activities (Senplades, 2013). Chronic poverty remains an important issue across Ecuador – 15% or more of the population are chronically poor in all regions – but it is especially widespread in the Amazon region. The gap in chronic poverty across geographical regions has not changed substantially.

Again, gaps are less pronounced for other indicators of living standards (including access to electricity, improved sanitation and safe water, and adequate housing), and access to education in particular. Data from the 2014 ECV suggest that access to primary education has increased considerably since 1995 and is universally high across all regions (90% or higher). Access to secondary education has also improved over the same period (rates > 75%), although the Sierra region has higher levels than other regions and universal attendance has not yet been achieved.

Ethnicity and indigenous status

Ecuador is a multicultural (or pluri-national) country. Most of the population is mestizo (mixed indigenous and European descent) (72% in 2010), and the remaining groups (indigenous, Afro-Ecuadorian and people of European descent) represent around 6–7% each (INEC, 2010). Poverty is disproportionately concentrated among indigenous groups: 65% of the population is poor compared with 30% of the Afroecuadorian population and 21% of the Mestizo population, respectively (Table 11). All ethnic groups have experienced a reduction in poverty between 2006 and 2014, but at different rates.

Table 10. Poverty by geographical regions, 1995–2014 (%)

	1995	1998	1999	2006	2014
Costa	36	46	53	40	25
Sierra	42	42	51	34	25
Amazonia	61	50	n/a	60	48
National	39	45	52	38	26

Sources: INEC 2014a.
Note: The Galapagos are not included in the ECV 1995–2006, but were included in the 2014 ECV.

28 Census data from 1990, 2001 and 2010 show an urban–rural gap that was somewhat constant – at around 30 percentage points – over this 20-year period (Secretaría Nacional de Planificación y Desarrollo (2013: 27, Table 1)).

29 Computed from data in Figure 4.

30 These regions have income poverty of 55.6% and 47.59% respectively according to ENEMDU, June 2015.

Afro-Ecuadorians and mestizos experienced the greatest reduction (a difference of 19 and 13 percentage points respectively), while indigenous and 'other' groups (which comprise Montubio, coastal people of mestizo and indigenous descent, and people of European descent) experienced the least. In other words, while inequalities have narrowed considerably for Afro-Ecuadorians, for indigenous people, they remain pronounced. Extreme poverty also declined for all ethnic groups, according to ENEMDU data from 2006 to 2012, but again remained higher for indigenous people, Montubios and Afro-Ecuadorians.

Indigenous people, Montubios and Afro-Ecuadorians are also disadvantaged in other dimensions of wellbeing. For example, they have far lower levels of education, which affects their earning capacity. In the country as a whole, 7% of the population is non-literate, according to the 2010 Census, but among indigenous and Montubio populations it is 20% and 13% respectively (INEC, 2010). Data from ENSANUT (2012) suggest that 37% of indigenous peoples and 27% of Montubios have not completed primary education compared to 20% and 10% of Afro-Ecuadorian and mestizo groups respectively. Only about 6% of indigenous peoples are university graduates, compared to about 25% of mestizos and people of European descent. In terms of the labour market, 20% of non-paid workers are indigenous (Cepal, 2014).

Table 11. Poverty by ethnic group, 2006 and 2014 (%)

	2006	2014	Difference (%)
Indigenous	69.9	64.8	5.1
Afro-Ecuadorian	48.4	29.7	18.7
Mestizo	34.4	21.2	13.2
Others*	33.1	30	3.1

Source: ECV (2006; 2014).

** Includes Montubio and populations of European descent.*

4.2 Fully implementing the principles of 'Buen Vivir'

One of Ecuador's strengths is a constitution that establishes 'Living Well' as the ultimate aim of policy-making and has an explicit commitment to the realisation of social rights, collective citizenship and environmental rights. In its practical implementation, it recognises two strategies, sustainability and innovation.

A first important challenge facing Ecuador is in advancing in the three core areas of 'Living Well' (human development, harmony with nature and a knowledge-based economic model), avoiding the potential trade-offs among them. This is especially true given criticisms of the government about the increasing gap between the rhetoric and practice of *Buen Vivir*.

A key issue is that the efforts in terms of social policies to advance human development have not been matched by an equal commitment to advances in the transformation of the economy or protection of the environment. In fact, some improvements in human development may have occurred at the expense of the environment. Notably, while the increase in the oil price has been a key factor in enabling increased social spending, dependence on the exploitation of natural resources has deepened. The government has promoted new investments in the oil sector, including highly controversial projects in protected areas in the Amazon region as well as large-scale mining projects, such as open-cast gold and copper mines. The exploitation of natural resources has been justified in order to finance social spending, and in the slogan 'We cannot be beggars sitting on a sack of gold'. Many political and civil society organisations (CSOs) have challenged this strategy, claiming that the extraction and depletion of the country's natural resources cannot be considered a sustainable redistributive strategy. Indigenous groups have strongly criticised the fact that the 2008 Constitution establishes only a right to 'prior, free and informed consultation' regarding the use of extractive resources (Larrea, 2008: 80), while the decision of whether to proceed with extractive projects remains with the state, as does ultimate sovereignty over all territory and resources (Radcliffe, 2012). A further problem with a growth strategy based on the extractive sector is that so far it appears to have constrained advances in the structural transformation of the economy.

Another concern is the loss of traction for the realisation of participatory democracy and a pluri-national state in Ecuador. As discussed in Section 3.4, these principles were originally at the core of the *Buen Vivir* agenda, but the government has shown an increasing lack of commitment to their implementation.

In fact, there were signs of tension in the political debate between the government and social movements during the Constituent Assembly (Becker, 2011). The president of the Constitutional Assembly resigned weeks before the finalisation of the drafting process as the result of growing disagreements between him and Rafael Correa. The latter believed that there was too much participation in the drafting process, and did not personally accept some of the most progressive principles in the draft, such as setting stronger limits on the extractive industries, requiring that communities affected by such projects give their informed consent, and tolerance of social movements and protests (Ospina Peralta, 2008).

More recently, Correa's administration has been criticised for reducing the freedom of CSOs and closing spaces in which they could express voice and dissent. Some saw the creation of a secretariat[31] to coordinate, regulate and monitor non-government organisations (NGOs) and social movements in this light (Acosta, 2009). Legislation on CSOs states that those participating in activities that could interfere with public policies can be closed down (Ortiz Lemos, 2014). Many argue that the new regulations aim to bureaucratise participation, confront social movements and exert control over the media and universities (ibid.). For example, honouring the spirit of the *Buen Vivir* agenda, and promoting empowerment across society, would require reactivating the mechanisms for citizens and civil society to participate in policy-making included in the 2008 Constitution but later abandoned in favour of more populist and, at times, authoritarian practices and policies.

4.3 Changing the structure of the economy and creating employment

The macroeconomic conditions described in the previous sections – especially the increase in the price of oil and dollarisation, with the ensuing revaluation of the exchange rate – supported economic recovery and stability in Ecuador, but simultaneously hampered its diversification into non-traditional manufacturing activities.

In fact, the economic structure has changed little since the 1990s. Trade and financial liberalisation introduced in that decade reinforced the model of export-led growth based on traditional exports, such as oil, shrimps and some agricultural commodities. The high price of oil and primary commodities that characterised the 2000s did not encourage diversification away from these activities. Over the course of the 2000s, Haussman and Klinger (2010) observe that Ecuador's export sectors are typical of much poorer countries and find little evidence of movement to new, more sophisticated export activities. Dollarisation did shift some job opportunities from the agricultural to the service sector, mainly commerce and construction, but many of these were in the informal economy and had low productivity.

The service sector accounts for the largest share of GDP and of employment, which underscores the dependence of the economy on domestic consumption, mainly driven by public expenditure (because services are non-tradable goods). At the same time, limited domestic manufacturing means that a large share of aggregate demand is satisfied by imports. High import levels have been sustainable thanks to dollarisation and the high oil price, which guaranteed an inflow of hard currency. Should these circumstances change, however, the country will have to tackle an unsustainable pattern of domestic consumption.

There is evidence that private economic activities have not thrived in recent years: in 2012, Ecuador had one of the world's highest established rates of business ownership, but a relatively low rate of new business ownership (World Development Indicators, 2015). Furthermore, the proportion of people working as entrepreneurs because of necessity increased between 2008 and 2013, while those motivated by such opportunities decreased, suggesting that entrepreneurship is driven more by the difficulties of finding employment in the formal economy than by new ideas and developments. Part of the problem may come from the concentration of productive activities in a small number of firms, which limit market entry and competition (Oxfam International, 2013). For example, two firms control 76% of the market in the production of hygiene items, while five firms control 71% of the production of grain products (Machado, 2012, cited in Oxfam International, 2013).

Particular attention should be focused on the agricultural sector, given that poverty is predominantly a rural phenomenon. The decline in poverty and inequality observed in the rural sector does not appear to be associated with structural changes in agricultural production or land redistribution – indeed, no interventions of this nature were introduced in the 2007–2011 period (Ponce and Vos, 2014). Tackling rural poverty would require measures to increase the productivity of small farmers and enhance off-farm income-earning opportunities. The former would include improved access to land (possibly through agrarian reform), water and credit; the latter investment in off-farm activities and the creation of linkages with regional, national and international value chains (for example in the agri-food sector).

From 2013, the government began to focus more on policies to 'change the productive matrix', with the aim of reducing the economy's dependence on commodities, and on low productivity services. Investments in Ecuador have increased, but these are driven by the public sector that accounted for 53% of investments in 2013. Although it is expected that some of these investments will have a significant impact on the productivity of new economic activity, it is uncertain which sectors are likely to flourish. For significant economic structural changes to occur, there will be a need for agreements with investors and the private sector. This might require a change in the government's strategy of tightly regulating the private sector. Further, the size of public investment may decline in the future following the drop in oil revenues.

The government has also been promoting the idea of the 'social and solidarity economy', which refers to an economic sector comprising cooperatives of small producers, social enterprises and microcredit unions. There has, however, been little action to put this idea into practice, and the limited evidence available suggests that the interventions to date have not significantly changed

31 The Secretariat of People, Social Movements and Citizen Participation (Secretaría de Pueblos, Movimientos Sociales y Participación Ciudadana).

‘We have learned how to do progressive policies. The challenge is to adjust these policies to a period of austerity. We do not know how to, yet’ – Former member of the government

the structure of the economy (Ponce and Vos, 2012). Some (e.g. Ponce and Vos, 2012) argue that pursuing a ‘popular and solidarity economy’ may have the unintended effect of increasing inequality, by promoting the growth of a low-productivity sector with limited linkages with other sectors in the economy and low export potential. This argument assumes, however, that the enterprises in the solidarity economy have low productivity and tend to remain informal. Government officials interviewed agreed that the ‘popular and solidarity economy’ policies had yet to achieve much, and that better results could be attained by developing stronger value chains in specialty products such as cocoa and coffee.

Moreover, further reduction in poverty and inequality will depend on the creation of more and better quality jobs for low-skilled people in both rural and urban areas. While the reduction of unemployment has been significant (it is now at 4%), less progress has been achieved in improving the quality of employment. For example, 52% of the population did not have ‘appropriate employment’ in March 2015, meaning they were working less than 40 hours per week and/or were not receiving the minimum wage (INEC, 2015b). Informality has continued to increase over the last few decades (Ponce and Vos, 2014) and precarious employment[32] in Ecuador is at a much higher level today than before 1999 and is significantly higher than the LAC average. Informality affects poor households disproportionately: in 2010, only 13% of the poorest decile was employed in the formal economy, compared to 49% in 1996. The opposite trend is observed in the richest decile: in 1996, 65% of these workers were in the formal economy, rising to 74% in 2010 (Ponce and Vos, 2012).

Finally, diversification of the economy is also necessary to increase the absorption of skilled workers, especially of young educated people. In fact, data suggest that unemployment is higher among this group: 43% of the unemployed are between the ages of 15 and 24 years, and 30.3% between 25 and 34 years of age (ENEMDU data). This, compounded by a decrease in the returns from education from 5% in 2007 to 4.2% in 2013 for formal workers (World Bank 2014), signals an inability of the economy to absorb a potentially productive part of its workforce.

Creating decent jobs for informal, low-skilled workers will require investment in the diversification of the economy as well as continued investment in education and workers’ training. Absorption of skilled workers demands increased investment in sectors that are labour-intensive but incorporate a medium to high level of technology.

4.4 Successfully navigating economic downturns and political transitions

At the core of Ecuador’s success was an increase in social spending enabled by the combination of very specific economic and political circumstances. The high oil price expanded revenues, and the government, driven by a redistributive national development plan and the need to maintain high levels of public support, used the additional resources for public spending. Inflationary pressures were prevented by dollarisation as well as by a period of conservative fiscal policy that preceded the post-2007 increase in public expenditure. These favourable conditions, however, may not pertain for much longer.

For example, the international price of oil has fallen during 2015 to an average of $52 a barrel, much lower than the government has faced before. Lower oil prices imply lower government revenues and lower inflows of hard currency, which, in the absence of a national currency, poses a further constraint on public finances (and on imports). The situation is aggravated by the absence of reserves, saved from previous oil funds, as these have been spent. The only options currently available to the government are borrowing or reduced spending. The first option would imply further increasing the national debt, which had reached 29.3% of GDP in April 2015 (Ministry of Finance, 2015). This is not yet at the constitutional ceiling of 40% of GDP, but has increased by 10 percentage points between 2013 and April 2015. In addition, this figure does not include financing obtained by other government mechanisms, such as oil-backed loans

‘It is too soon to know if this model is successful. The government proposed it under very favourable conditions. Now conditions are changing and it is uncertain the model will produce satisfactory results under international constraints’ – Researcher

32 Precarious employment refers to the working population at risk of weak and unreliable incomes. According to the International Labour Organization (ILO), two types of employment fall into this category: contributing (unpaid) family workers and the self-employed (working on their own account). These two categories are less likely than wage workers (employees) to have formal working arrangements, be covered by social protection systems or have regular earnings.

with China. Other analysts suggest that including these mechanisms meant that the debt amounted to 37% of GDP by April 2015 (*El Universo*, 2015). The second option, reducing public expenditure, could have a negative impact on the poor and slow down economic growth, given the state's major role in the economy. So, the government faces the difficult challenge of maintaining a progressive social programme while undergoing an economic downturn with limited resources and without expanding the public debt to dangerous levels.

These difficulties are also exposing the constraints posed by dollarisation in a context of declining commodity prices. As mentioned in Section 3.1, dollarisation helped to achieve macroeconomic stability and economic recovery after the 1999–2000 crisis. Its positive effects depended, however, on the presence of three factors: the devaluation of the currency before dollarisation, the ability to maintain fiscal discipline after the crisis, and high oil prices. Oil exports were particularly important in enabling a constant inflow of dollars, which, in absence of a local currency, was essential to undertake all other economic transactions. For this reason, many analysts consider that without oil exports, dollarisation would have been untenable. Moreover, dollarisation played an important role in preventing appreciation and inflation (the Dutch disease) that usually follows large inflows of revenues in resource-rich countries. Imports – rather than the exchange rate – became the adjustment variable. The additional dollars in the economy allowed imports to rise from an average of $9,000 million annually in the first period (2000–2006) to $23,000 million annually in the second period (2007–2012) (Banco Central del Ecuador). Experts consider that dollarisation helped to provide credibility to economic policies, reduce the country's exposure to risk, create positive conditions for sustainable economic growth and increase incomes.

On the other hand, however, the process eliminated the national currency and then limited Ecuador´s capacity to adopt counter-cyclical economic policies. Without a national currency, managing the exchange rate cannot be used as an instrument to promote non-commodity exports. In this scenario, sustainable growth depends heavily on higher productivity to maintain the real exchange rate within competitive levels, given that the dollar is a strong currency (World Bank, 2004). In this sense, Ecuador's performance remains poor: the productivity gap (i.e. the ratio between USA's and Ecuador's productivity) increased between 1980 and 2011, and the increase has been one of the largest in Latin America after Nicaragua, Bolivia and Paraguay (OECD, 2013). Since the gap measures the distance of a country's productivity level from the technological frontier (using the USA as a benchmark), this indicated that Ecuador has been losing competitiveness with respect to other Latin American countries and the USA. In the absence of a counterfactual, it is difficult to know whether other stabilisation strategies would have worked better. What is certain, however, is that while dollarisation has provided some benefits over time, it was an almost irreversible decision, and as a consequence Ecuador is now facing difficult economic challenges.

Other challenges are political. Rafael Correa has been in power for the two consecutive terms permitted in the Constitution. In February 2013, Correa won a third mandate, but faced growing opposition from some of the social movements that had supported him in 2006, as well as from former collaborators. It is uncertain how events within his political movement and among other political parties will evolve until 2017 when a new president will be elected. As discussed earlier, the political priorities and policies that were adopted were not agreed through broad political negotiation, but were imposed thanks to the overwhelming power of the government party in the executive and legislative. The current situation may be 'good enough' to maintain power and put forward some redistributive policies, but there are signs that political instability is re-emerging. The political power that became Rafael Correa's main tool for transformation may limit successful transition to a new political regime.

4.5 Maintain high levels and quality of social expenditure

The increased public spending on social protection, health and education have enabled important improvements in the lives of the poorest people, leading to a significant reduction in poverty and inequality. However, as seen in Section 4.1, levels of inequality and deprivation in income and other dimensions remain high, especially for certain population sectors, such as women and indigenous peoples. At the same time, social expenditure remains below the Latin American average.

Addressing these problems calls for continued public investment in social protection, health and education, and improved quality of, and access to, these services.

Despite the improvements achieved in the last years, the provision of public services in health and education is often inefficient. For example, there have been investments in hospital equipment, but primary health facilities have been overlooked, especially in rural areas. The primary school enrolment rate is high, but the quality of education remains a concern (Oxfam International, 2013). These inefficiencies are largely due to difficulties in managing the increased resources channelled to the sector, which have led to a focus on the value of disbursements rather than on the quality of service provision (ibid.). In general, there has been inadequate planning and coordination between the ministries and the social security system (ibid.).

Improving quality and reducing inefficiencies is necessary to ensure that improvements in human development benefit all sectors of the population – including those still experiencing marginalisation and discrimination. This in turn requires that levels of social expenditure do not decline in the future, and ideally that they keep rising in line with the Latin American average. Changing economic and political circumstances may challenge the country's ability to do so, however.

As discussed above, changing economic circumstances are resulting in a deterioration of the country's public finances. Future governments may place a different emphasis on social spending and take a different approach to public resource management. This is true for any country, but in Ecuador the risk seems higher than in many because the emphasis on social and redistributive policies was strongly associated with Correa's political will and political strategy, and with his government's radical strategies to create fiscal space for public expenditure. It is possible that the public discourse on redistribution and social services developed over the last few years has had a long-lasting impact on citizens' willingness to demand services, and that this issue will remain at the core of future political campaigns. On the other hand, new political forces might challenge the political and economic strategies of the past and reverse some of the existing social policies. This could undermine some of the progress achieved in reducing poverty.

5. What lessons can we learn?

Ecuador. Photo: © tpsdave.

In the late 1990s, Ecuador was affected by a vicious cycle of political instability, economic crisis and increasing poverty and inequality. Fifteen years later, it has achieved a remarkable decrease in poverty and inequality, as well as economic and (relative) political stability. The vicious cycle appears to have been broken, and many problems are being addressed. These positive outcomes were made possible by a combination of economic and political factors.

Some of the factors that enabled Ecuador to break this cycle are peculiar to the country (e.g. Rafael Correa's political strategy), may not be desirable elsewhere (e.g. dollarisation) or cannot be controlled by national policies (e.g. the international price of oil).

There are, however, important lessons that can be learnt from Ecuador's experience of domestic macroeconomic management, the creation of fiscal space, the pros and cons of strong political will and making the most of favourable external conditions.

An explicit focus on inclusive policies beyond economic growth is essential for poverty reduction. The reduction of poverty and inequality can be achieved even with moderate rates of economic growth if a government redistributes jobs and income, and resources, through social expenditure aimed at the poor. The case of Ecuador shows that inclusive policies can mediate growth so that its benefits reach the poor. The recovery from the crisis and the positive market for commodities are important factors in the reduction of poverty, but equally relevant were the policies explicitly adopted to benefit the poorest households through a combination of cash transfers, free health and education services and regulations to improve wages and work conditions.

It is possible to create fiscal space for social expenditure through 'unconventional' measures, provided there is sufficient political will and commitment to redistribution, but to prevent negative macroeconomic consequences they should be employed in the context of counter-cyclical

macroeconomic management. In Ecuador, increased social expenditure was associated with radical reforms in public resource management and the creation of fiscal space through measures such as restructuring of foreign debt and increasing royalties from oil extraction. Such measures were not accompanied by counter-cyclical management, however, and in the context of changed external economic conditions, the government is now facing severe constraints on its spending capacity.

Countries that are rich in natural resources can create considerable fiscal space through using revenues from the export of these commodities to finance public investment and social policies. It is also necessary, however, to balance current spending with future needs and, therefore, save part of these resources. In other words, each government should seek to optimise the allocation of resources by taking into account the needs of both present and future generations.

A strong government, political will and commitment to inclusion and redistribution make it easier to achieve increased social spending and to implement programmes for excluded sectors of the population. They also, however, limit progressive social change if they are accompanied by the closure of spaces for civil society participation. In Ecuador, the initial traction demonstrated by Correa's political regime for bottom-up, participatory policy-making has been replaced by authoritarian tendencies compounded by the closure of spaces for CSOs to participate. These tendencies undermine the country's progress towards a more equal and democratic society.

Reducing dependence on commodities export (oil in particular) is essential in the medium to long term in order to ensure sustainable economic growth and stable macroeconomic conditions. In Ecuador, the combination of dollarisation with oil reserves in a context of high oil prices created the conditions for growth and economic recovery – but they also reduced the incentives to promote a diversification of the economy towards tradable, labour-intensive manufactured goods and to invest in improved productivity. In the context of declining oil prices and lack of a national currency, it is more difficult for Ecuador to maintain a sustained path of economic growth.

Favourable economic and political conditions can compensate for the lack of structural change in the economy and society for a limited period – but ultimately eradicating poverty and sustainably reducing inequality requires removing the structural causes. Structural economic change implies the diversification of economic activities so that job opportunities are created for all sectors of society and productivity increases. Social change that eliminates the discrimination and exclusion of traditionally marginalised groups is essential to ensure that economic transformation does not lead to greater inequality. Ecuador faces the challenge of advancing this structural change in a context of evolving economic and political conditions.

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