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Master in Economic Development and Growth

The understanding of development in Ecuador through institutions and beliefs, 1950-2014

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Abstract: This thesis analyzes Ecuadorian development through a historical perspective, in which the changes related to institutions and beliefs are crucial for the explanation of their dramatic transformation. In this respect, during most of its history Ecuador was characterized for lack of leadership, high external dependence, corruption, selfish interests of groups of power, and huge instability. Indeed, their weak institutions were considered the major cause of its backwardness, since certain beliefs and customs hindered the incentives for institutional change. However, since 2007 Ecuador broke away from its past. That is, this country entered into a new development path towards a more open society in economic and political terms. The 'analytic narratives' methodology found support for institutional change process based on the emergence of a window of opportunity, the strong presence of a leader and the consequent establishment of a solid constitutional process. As a consequence, some indicators demonstrate the significance of these changes, such as: increases in economic growth rate and social spending and decreases in unemployment, poverty and inequality. Lastly, the evolution of certain customs and beliefs in favor of social welfare and national progress largely support the beginning of a new trajectory towards a more open society.

Key words: Institutions, beliefs, leadership, outcomes, open society.

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1. Introduction

There is a lot of literature explaining the major cause of differences in economic development between developed and developing regions. In this respect, the most widespread reason argues that 'institutions' are important for economic development and growth (Engerman & Sokoloff, 2002; Aron, 2000; Acemoglu, et al, 2001; Rodrik 2004). But, it is necessary to consider that development is contextual, i.e. that economic and political results will depend on the specific time and space regarding different institutional arrangements that shape different development paths.

In this vein, there are some countries that broke away with its past through big changes in its development trajectories. It implies the transition towards a more open society in order to achieve better outcomes. Thus (North, Wallis, & Weingast, 2009) argued that open access societies are more likely to promote economic growth, sustained political development and social stability.

Within this context, since 2007 Ecuador has changed its path towards a more open society in economic and political terms. So, it is fundamental to analyze the economic history of Ecuador to better understand the way this country has entered into a process of changes, concerning beliefs and institutions, which have determined its transformation.

In order to achieve the long-awaited development, Ecuadorian governments have used different strategies including developmental models, planning programs, etc. Unfortunately, during most of its history, the lack of leadership, high external dependence, selfish interests of elites, huge instability besides certain customs and beliefs hindered the incentives for institutional change.

The 1970s was characterized by several dictatorships and a slight economic improvement due to high international oil prices, stressing that oil became the first item of national income (Acosta, 2012). But political unrest was prevailing in those years, since the military abused of their power against national interests. During the 80s, democracy was restored for the wrong reasons, because certain groups did not want to lose their power, and they chose 'democracy' as a rapid solution to their problems. In 1999, a major financial crisis destabilized the country that adopted the 'dollarization' to solve the severe effects of the

crisis. After that event, Ecuador had quite unstable democracies that caused a crisis of political representation.

In 2006 Rafael Correa took advantage of that circumstance to establish his beliefs and change society in a positive way. This fact was almost impossible considering the unstable past of the country. The poor social beliefs constituted the main constraint of national progress. So, Ecuador during this period (2007-2014) has shown strong evidence of the start of a new era. Some indicators demonstrated the significance of these changes, such as: economic growth rate and social spending with an upward trend; and unemployment, poverty and inequality with a downtrend.

Correa's leadership is crucial to comprehend the change of the country's trajectory towards a more open society. While it is true, that the outcomes reflect dramatic progress regarding distributional equality and equity; the beliefs and institutions has evolved remarkably in Ecuador. In this context, to better understand the break away with the past, this study will focus on the last 64 years (1950 - 2014). Thereby, this Master thesis will investigate the changes in beliefs and institutions over time.

Besides, the motivation arose from the personal interest in the contribution of this kind of studies for Ecuador. This country has quite few studies that explain their transformation since 2007. So, it is necessary to provide a significant academic tool regarding institutions and development in Ecuador. The main objective of this study is to analyze the fundamental changes related to key features of open societies.

In this respect, this thesis wants to test the following hypothesis:

- *The constitutional process is the main trigger of institutional change in Ecuador because it has transformed the economic and fiscal policies to achieve a more open society.*

In order to find support for the given hypothesis, this study will rely on circumstantial evidence¹ that will be provided by the analytical narratives. As (Alston et al., 2013) pointed out some areas like economic history must rely on circumstantial evidence, which shows

¹ Alston referred to (Fogel, 1982) in which circumstantial evidence was defined as a kind of evidence that tends to prove a fact based on a reasonable inference in order to link it with a conclusion of fact.

that certain facts or circumstances that are usually linked with the hypotheses have occurred. Therefore, it is reasonable to infer with certain probability that the given hypothesis should not be rejected. But it must consider that the inference can be quite convincing depending on the strength of the link between circumstantial evidence and the hypothesis.

Concerning the methodology, this investigation will use ‘analytical narratives’, mainly the one that was developed by (Alston et al., 2013). They studied a similar case for Brazil, in which they created a conceptual framework with some key concepts to better comprehend the way countries broke away of its past. Also, they stressed the validity of this framework to study some cases in Latin America. That is why I chose this methodology to analyze the Ecuadorian case. The concepts include windows of opportunity, beliefs, leadership, institutions and outcomes. But the analysis takes into account the interaction of these concepts, since this play a crucial role to better comprehend this issue.

This Master thesis proceeds as follows: section 2 provides a comprehensive literature review. Section 3 presents a description of the methodology and data. Section 4 shows the major conceptual framework based on the forthcoming book developed by Lee Alston. Section 5 discusses in detail the economic history of Ecuador for the entire period 1950-2014, divided into three stages 1) 1950-1979; 2) 1980-2006 and 3) 2007-2014. And, section 6 presents the conclusions.

2. Literature Review

2.1. Institutions, Institutional change and Economic Development

(North, 1990) defines institutions as ‘rules of the game’ in a society, or more specifically the humanly devised constraints that shape human interaction. These comprise formal and informal rules and its enforcement characteristics². North was the first economist who gave prominence to the role of institutions as major determinants of long-term economic performance (North, 2005).

² Formal rules refer to property rights, constitutions, norms and regulations, codified and enforced by impersonal mechanisms. Moreover, informal constraints include traditions, taboos, customs, and codes of behavior; enforced by personal ties.

In this respect, there is a widespread assumption that institutions matter for economic development and growth according to mainstream economics (Engerman & Sokoloff, 2002; Aron, 2000; Acemoglu, et al, 2001; Rodrik 2004). But it is important to consider that development is contextual. In other words, the development paths related with successful economic development have been promoted by different institutional arrangements. Then, which institutions are vital and which are not will vary depending on time and space. Likewise (Rodrik, Subramanian, & Trebbi, 2004) showed that desirable institutional arrangements include specificity of context, which arises from initial conditions and from differences in historical and geographical backgrounds. Additionally, there is no perfect combination of institutions for all countries, however many development economists agree that economic progress requires some specific institutions that must be adapted to local circumstances, such as property rights, regulatory institutions, institutions of conflict management, and social security institutions (Rodrik, 2000).

Turning to the main concept of institutions, North said that formal rules reflect the ideological belief system of agents, especially those who are strong and influential. His investigations showed the topic relevance in theoretical terms. As an illustration, (North & Weingast, 1989) analyzed the constitutional arrangements in the seventeenth century in England. The political institutions established restrictions on government abuse and opportunism to create economic growth. Thereby, institutional change combined the institutions with government to achieve the same goals such as protection of property rights and social welfare.

Besides, the interaction of formal and informal rules allows organizations to create equilibrium. Thus, a set of beliefs emerge in relation to the institutional environment, in which institutions reflects rational behaviors conditioned to social expectations (Fukuyama, 2006; Calvert, 1995). Similarly (Aoki, 2001) argued that institutions show shared beliefs system about expected behavior of individuals. (Greif, 2006; Eggertsson, 2005) also emphasized the role of beliefs in order to better understand institutions and institutional change.

Institutional change is a difficult and long process due to complex interactions between institutions and organizations with several change horizons. In this sense, institutions are

dynamic since they reflect those simultaneous interactions that shape institutional evolution (North, 1994). Thus, several authors argue that institutional change is a centralized collective choice process in which the rules are specified by the State. So, individuals and organizations establish collective actions in order to modify the rules for their own benefit.

Concerning economic and fiscal policies, these have a crucial role in the sustainability of institutional change, since these policies become instruments of government to change and improve the 'rules of the game'. But this process takes time because even the best institutions do not automatically lead to right policies (Kolodko, 2005; Hasan et al., 2006)

(Ostrom, 2005) argued that institutional change occurs when individual expectations (cost and benefit) match a coalition that in democracies represent the majority. This process contains some kinds of hierarchical rules, such as 'operating rules'; the 'collective choice rules' and the 'constitutional rules'. Further, there are some obstacles for effective institutional change, for example: the bounded rationality of individuals, since some of them may have misconceptions about the possible effects of institutional change. They prefer institutional innovations derived from successful institutional examples from developed world, which do not always work in developing countries.

Moreover, the powerful groups can hinder institutional change, thereby it is necessary the presence of an external authority to enforce negotiations between winners and losers of this process. In this vein (Acemoglu & Robinson, 2006) create a theory of constitutional change that highlights the problem of negotiations. This theory explained how marginalized groups use violence to achieve constitutional changes especially in crisis times, which is the right moment for negotiations between the leaders and marginalized groups. Leaders commit to make reforms as long as the other group does not use violence. But, these commitments are not always complied. Likewise, (Levi, 1990) stresses that the formal rules grant power to minority groups, so the majority or the marginalized groups may force institutional change by their dissatisfaction with existing institutional mechanisms. This discontent can be reflected in collective or decentralized actions in society.

(Alston, 1996) explained that institutional change is the result of the forces of supply (government) and demand (voters) in a society because the negotiations between them play

a key role in the process. These groups compete to shape the formal rules to their advantage, for instance constitutions. Accordingly, political actors reflect the interests of the majority groups. Similarly (Kaufman, 2007) said that policy determines the rules of the game and these in turn affect economic performance. Then, rules are often created and enforced by the state. In the case that the rules are inadequate, individuals will try to modify them through legislation, since the judiciary also plays an important role in the direction of institutional change.

Unlike the authors mentioned above, which explain institutional change as a process based on design, there are also extensive literature that assume institutional change as an evolutionary process. Therefore, in some economies, transaction costs arise by bounded rationality and opportunism of the parties. When the transaction costs are minimal, several rules and governance structures can govern effectively. Thus the outcome is predetermined because the most efficient institutions are those that emerge and persist (Williamson, 2000).

Additionally (Veblen, 1899) showed that institutional change is related to the evolution of social structure including natural selection of institutions. I.e., a process of natural selection of the fittest mental models must adapt to the space through the formation of new institutions that includes development of habits of thought. Since it is an evolution; the mental models of the past can influence the future process. Furthermore (Hayek, 1973) argued that institutional change is based on elections social groups. Thus, the rules of conduct evolve because groups that practice them are more successful, and displace other less efficient rules. Thereby, through group selection, this configuration of rules evolves towards an optimal configuration based on consistent principles, such as: freedom centered on protection of property rights.

(Young, 1996) affirmed that institutional change is a process of punctuated equilibrium, in which the history leads to the selection of self-enforcing rules in long periods of stability. Then, the appropriate institutions that promote growth arise and persist over time. Likewise, (Hodgson, 2004) indicated that the exogenous parameters lead to institutional evolution, for example technology changes that cause changes in institutions.

Regarding to the order of societies, (North, Wallis, & Weingast, 2009) explored the organizational bases for development through an institutional explanation. They describe the properties that differentiate limited and open access societies, and also the conditions conducive to the transition from one society to another with the objective to achieve economic prosperity and political order through violence control. Those societies represent the major two social orders in the world.

Specifically, in limited access orders, the elites control the violence through the creation of income from restricting entry into economic and political system. Further, the government is centralized and their involvement in the economy is minimal. The market power grows and the competition is restricted, property rights are insecure, besides inequality and injustice have an increasing trend due to the dominance of social hierarchies and abuses of power. On the other hand, open access orders seek social stability through political and economic competition. The government is decentralized and has a high participation in the economy, there is also enforcement of rule of law, and property rights are secure. Equity and equality prevail in society leading to sustainable economic and political development.

In this context, open access orders are more likely to promote economic growth, sustained political development and social stability. Turning to the circumstances that led the transition from one social order to another, they established three sets of doorstep conditions: 1) rule of law for elites; 2) existence of permanent active organizations; 3) political control of the military. In this respect, when a society has achieved most of these conditions can be stated that they reached the entrance of open access. Lastly, the authors emphasize that the transition is neither an automatic process nor definitive. This process must be approved by elites to institutionalize appropriate orders in the country.

2.1.1. Institutions and Development in Developing Countries

(North et al., 2013) argues that most developing countries are related to social dynamics of limited access orders. Thus, this region face certain challenges; first the development of 'limited access orders' to achieve the control of violence, more economic growth, greater social welfare, and stable outcomes; second, the transition from limited access to an open access society through the control of violence and the improvement of living conditions.

The transplant of characteristics of open access societies is not enough to succeed; these countries have to adapt the key features, such as greater predictability of law enforcement, increased revenue, greater equality and high political participation. In this sense, the institutions in the developing world vary widely, both in terms enforcement and durability. This variation has important implications for the creation and function of proper institutions over time (Levitsky & Murillo, 2009).

(Engerman & Sokoloff, 2002) claimed that in developing countries, the initial factor endowments affected emerging institutional structures that mostly hindered development. The countries that had the best endowment of resources were selected by the colonizers to extract cost effective products, whereas resource-poor regions were chosen for less profitable activities. Thus, the different strategies of colonization led to the path dependence or institutional persistence. In this context, countries that searched richness and power established exclusive institutions. Conversely, those regions that looked for social welfare are more likely to develop inclusive institutions, greater openness and hence economic growth.

In addition (Acemoglu et al., 2005) said that the economic performance in the region reflects institutional characteristics established in colonial times and inherited by postcolonial states. Then, bad economic and political institutions are the central cause of economic backwardness. Certainly, developing countries are poor because its institutions are defined by a weak structure that does not create incentives and undermines development (Hasan et al., 2006). Besides, the poverty in this region is the result of the absence of institutional arrangements and the interaction of perverse institutions that are not growth promoting (Chu, 2003). In this vein, (Acemoglu et al., 2001, 2002 and 2008) stated that the lack of good institutional features hampers development. Indeed, the cause of underdevelopment lies in the predominance of extractive institutions, poor initial conditions and resource endowments.

Finally, in order to solve the problems of underdevelopment, some developing countries import the formal rules of a developed country. It will get different outcomes compared to the original region, considering changes in informal rules and enforcement features. So, the successful transfer of formal rules is not a sufficient condition to generate good economic

results since it is necessary an adaptation process and a certain degree of institutional innovation (Chang, 2005).

2.2. Analyzing the impact of Institutions

Among the most important empirical contributions, (Acemoglu et al., 2002 and Easterly & Levine, 2003) affirmed that resource endowments are essential for growth, i.e. elements that provide favorable conditions for the emergence or survival of institutions. Also, several investigations are based in build-up of historical cases that represent strong explanations about how institutions adapt efficiently to seize opportunities (North, Wallis & Weingast, 2009; Krueger, 1997). Also, comparative historical work highlights the arrangements of State to shape the course of institutional change (North, 1990).

Regarding econometric studies, some of the most acknowledged works (Acemoglu et al., 2005; Kaufmann, 2004; Glaeser et al., 2004; Rodrik, 2003; Knack & Keefer, 1995) found that institutional quality is the determinant of poverty in the developing world. However, without dismissing the importance of these works, (Alston, et al 2013) said that researchers must be very careful in choosing and using variables to measure institutions because of some problems. On one hand, some indicators measure economic performance variables that vary over time reflecting a cyclical behavior instead of deeper determinants. On the other hand, other indicators are built based on perceptions of experts in certain areas related to the analysis of institutions. This includes limitations since these indicators may be susceptible to herd behavior³.

For this reason (Alston et al., 2013) developed an analytical narratives methodology to analyze the impact of institutions on development. In this respect, the authors argue that development is contextual. Developing countries should learn from the most successful cases of development. So, the leaders of the countries could take some central ideas of an open society and adapt them to their reality. Besides, institutions that are part of open societies emerge from a process of belief change over time. So, beliefs are also contextual,

³ Some examples of these kind of indices: ‘aggregate governance index’ developed by (Kaufman et al., 1999), ‘index of corruption’ developed by Transparency International; ‘economic freedom index’ created by Heritage Foundation; ‘international country risk guide’, ‘political risk index’, among others.

thus each country experiences these changes in different ways depending on its historical background and its resource endowments.

(Alston et al., 2013) analyzed the Brazilian case in which they argue that this country broke with its past and it is in transition to a more open society. This is confirmed by the analysis of its economic history over the last 50 years, and the changes in institutions and beliefs since 1994.

In summary, the analytical narratives shows conclusive evidence on institutions and beliefs shaping a new trajectory to a more open society, based on an important conceptual framework that will be detailed later.

3. Methodology

The methodology used in this study is called analytic narratives⁴. It combines a deep understanding of the case study with an explicit theoretical framework. The term “analytic” refers to quantitative tools; while the term “narrative” concerns a qualitative historical presentation of the data. This captures the assumption that theory linked to data is more powerful than either data or theory alone. Further, the emergence of this methodology was influenced by previous work of Douglass North, since it helps to explain the institutional origin and change.

This Master thesis takes elements established by (Alston et al, 2013) who develops a conceptual framework defined by some key concepts for the analysis of similar cases in Latin America. These concepts include windows of opportunity, leadership, institutions, beliefs and economic and political outcomes. In the case of Ecuador, the framework uses the same concepts and it also adds some other concepts based on the country context specificity. Also, it is important to consider the interaction of these concepts to comprehend the break with the past and the start of a new era.

⁴ This methodology was first developed by (Bates et al., 1998).

In the framework developed by (Alston et al., 2013), the 'analytic narratives' require circumstantial evidence to test the hypothesis⁵. This kind of evidence could show that certain facts or circumstances that are associated with the hypotheses have occurred. Thus, it would be reasonable to infer with certain probability that the given hypothesis should not be rejected. But it must consider that the inference can be quite convincing depending on the strength of the link between circumstantial evidence and the hypothesis. If the relationship is very strong, the case study will have greater relevance.

To conclude, this method isolates the impact of a theoretical concept in a more detailed and potentially more compelling manner (Alston, 2008). Furthermore, 'analytic narratives' also distinguish between affirmations and predictions. The assertions include past events that are analyzed and verified with evidence, while the predictions indicate what the author thinks will happen in the future (Alston et al., 2013).

3.1. Data

The data used in analytical narratives are qualitative and quantitative. In this sense, quantitative data were obtained from various sources based on historical evidence such as papers, annual reports of international organizations, publications, economic history books, etc. Moreover, quantitative data were obtained from books and reports of Ecuadorian statistics, National Institute of Statistics and Census, Central Bank of Ecuador, ECLAC and the World Bank.

4. The Major Conceptual Framework

Due to the differences in institutions between developed and developing world, it is impossible to get a guide that details what are the proper institutions and how to obtain them. As (Alston et al., 2013) pointed out, 'development' is contextual and 'institutional change' is rooted in different belief structures that shape the proper set of institutions. Thus each country has to adapt their institutions to their own characteristics based on time and space.

⁵ According to (Alston et al., 2013), analytic narratives do not have significant coefficients but instead includes extensive and significant circumstantial evidence, which is largely independent and can be very convincing.

(Alston et al., 2013) designed a conceptual framework with the objective to deeply understand the development paths taken by some countries in Latin America. Indeed, at first it was elaborated to comprehend the Brazilian case, but they highlighted its validity to understand some cases in the same region, obviously each case with their own results depending on context. The key concepts used in its work are: beliefs, leadership, windows of opportunity, institutions and economic and political outcomes. In addition, to analyze institutions and institutional change it is important to consider the interaction among these terms.

In this respect, the current framework use some terms since these are valuable and appropriate to explain the Ecuadorian case. In other words, this framework is modified and adapted to the country's reality. This is divided into two groups and other two concepts are also added. The first group includes beliefs and customs⁶; while the second group contains windows of opportunity, leadership and democracy. Lastly, the other concepts are interest groups and international relations.

4.1 Fundamental Concepts

First Group

➤ Beliefs

(Alston et al., 2013) defines ‘beliefs’ as the personal interpretation about the way the world works⁷. So, the beliefs generate an explanation of cause and effect, i.e. how different sets of institutions generate economic and political outcomes in different contexts. Further, the beliefs are contextual and these arise when there is a relationship between institutions and its results.

(North, 1993; 2005) noted that formal institutions reflect the ideological belief systems of economic agents. Also, the mental models are essential to shape decisions of leaders, so the beliefs should be coherent with the reforms. Since beliefs are subjective views, individuals

⁶ Beliefs and customs constitute slow-moving institutions that have greater impact to drive institutional change since its changes are slow, incremental and continuous (Roland, 2004)

⁷ This definition was taken of (North, 2005).

assign them an obligation character in order to expand their view to other people. Thus, the creation and survival of institutions are supported by the belief system of each country.

As noted before, there is no guide to obtain the best institutions with positive outcomes because of the high level of uncertainty. In a positive scenario, leaders get the expected results, so the dominant beliefs are strengthened. Conversely, if they do not get the anticipated outcomes, the dominant beliefs will be weakened and its power will decline.

The most important belief belongs to leaders, since they can seize the emergence of the window of opportunity and make timely decisions about the implementation of new institutions. But the beliefs of citizens should complement the leader's belief. In this regard, citizens may support or restrict the power of the leaders, according to their own benefit (Alston et al., 2013). So, leaders must consider that the institutions must be consistent with national beliefs in order to obtain expected results.

➤ **Customs**

According to (North, 1991), the 'customs' are considered one of the informal constraints that shape human interaction. Indeed, the 'customs' establish incentives and limitations for individual actions.

Similarly to 'beliefs'; this concept helps to understand how the world works. Whereby, the 'customs' largely explains the establishment and implementation of rules in a society. Then, the way citizens interpret and appreciate the rules has the same importance as the incentives and constraints in society. Thereby, the process of social interaction is built through valuation rules, in which developmental trajectories are shaped by the 'customs' (Hodgson, 2006).

The structure of beliefs is closely linked with the incentives and constraints for individual decision making. This structure helps to create 'customs' and preferences that should be consistent with its spread. So, the establishment of the 'customs' represents the root of beliefs in society. In this respect, beliefs are usually rationalizations of feelings and emotions emerging from the 'customs' established by the individual behavior (Wood et al., 2002)

The decisions made by leaders are internalized in the preferences and these are replicated through individual behavior. In that way, the 'customs' provide a normative weight to political decisions and stabilize institutional imbalance. Also, the normative power of a custom is explained through human interaction, in which beliefs are based on pursuit of welfare, as a result it represents social power.

Certainly, the prevalence of institutions is embedded in the customs of society, whereby it is required institutional change to get expected results and achieve development in Latin America.

Second Group

➤ Window of Opportunity

A window of opportunity is a short period of time in which there is a unique opportunity. It should be exploited at the right time, in which immediate action is paramount. So, once the window of opportunity closes, the opportunity vanishes forever.

The window of opportunity arises when the economic and political outcomes differ from expectations (Alston et al., 2103). This opportunity allows changing institutions due to malleability of beliefs. In this sense, it fosters the beginning of a process of change.

The leaders should take advantage of the window of opportunity. They have the chance to modify institutions according to the dominant beliefs. Nevertheless, the windows of opportunity are not always exploited, due to the lack of natural leaders or blocking of changes. Therefore, the economic or political outcomes could also be negatives. Further, the prevalence of past beliefs affects the relationship between institutions and outcomes. As an illustration, the crises represent windows of opportunity, but the crises are not a necessary condition for its emergence (Alston et al., 2013).

The windows of opportunity appear in three specific scenarios. First, when rental streams are not sufficient or otherwise exceed the expectations of leaders. Second, a new member enters into the group of leaders, as a result of unintentional crisis that could be economic or politic. And third, the beliefs of leaders change due to an exogenous shock or changes in outcomes (Alston et al., 2013). To sum up, the leader through the window of opportunity

plays a crucial role in the pursuit of sustainable development. The interaction with their beliefs and customs provide relevance to the concept.

➤ **Leadership**

'Leadership' refers to certain individuals or organizations that seize the windows of opportunity and make difference due to their decisions and actions in country's history. The leadership is necessary for institutional change to the extent in which the leader is able to conduct their preferences through belief structure. The leader must have the ability to form alliances or coalitions to support their choices.

Further, the 'leadership' alone does not work; this concept also requires interaction with other terms such as respect and citizen support. The main objective is to promote an initial change to achieve expected outcomes regarding institutional strengthening and belief deepening. In this vein, the interaction between leadership and window of opportunity is quite important. Thus, the leader should seize the window of opportunity to decide whether or not the country should take another path (Alston et al., 2013). When the country enters in that path, institutional changes must be reinforced through time. If this process is successful, it will affect the belief structure, and as a result, it will allow the establishment of more institutional changes in the future.

The leaders are considered drivers of institutional change through the use of windows of opportunity. One interesting factor is its ability to solve problems rooted in the past. Nonetheless, leaders may also be wrong, and their decisions could lead to unintended negative results due to the high element of uncertainty about future.

The interaction of the core concepts leads to success of the leader. To understand this assumption, before being a leader, this person or organization must recognize the existence of the window of opportunity, and then it must establish decisions and expect results consistent with their beliefs. To sum up, the leadership is the ability to lead a country to success or failure.

➤ **Democracy**

Most studies on the relationship between institutions and economic development has been carried out on the basis of political structure and the role of government in each country. In this way the government challenge is to provide a good leadership to solve institutional weakness. That is, a commitment to create and implement development policies in the benefit of all citizens, stressing the importance of democracy.

For instance, in order to have an empirical notion of this concept, (Rodrik, 2000) analyzed data for 90 countries in the period 1970 until 1989. He found that the countries characterized by democratic regimes were more able to have long-term growth rates. Also these countries could better manage external shocks, create greater short-term stability and promote a fair distribution of income. In this context it is clear that the best results come from those countries with democratic regimes since these nations produce institutions with greater capacity to adapt to local conditions. Thus, democracies create better institutional outcomes because these establish greater equity in the nations especially in social sectors such as education and health.

Moreover, democracies are considered meta-institutions because these help to build better societies with the proper institutional arrangements (Rodrik, 2000). In addition, participatory democracy creates better institutions providing the basis for sustainable economic development. This concept also requires interaction of several terms, i.e. the presence of a good leader, the window of opportunity and strong belief structure.

This investigation uses the perception of (Rodrik, 2000), in which "democracies" work better than others regimes under several circumstances. In addition, democracies best handled crisis periods and the leaders get distributive results to achieve social welfare.

To Summarize: this section contains a separation of concepts in two different groups in order to better comprehend the definition and association between them. However, the development of the analytic narratives will not include a distinction between groups, because the crucial part of this approach is the interaction of concepts. In this sense, the interaction is fundamental to understand the way some countries have been separated from their past since these concepts alone do not generate the expected changes.

In this respect (Alston et al., 2013) emphasizes that windows of opportunity can be used by leaders, who may change the institutions to generate more open societies. It has also been proven that well-established democracies generated better economic and political outcomes. But it is not a fundamental requirement in all cases. Moreover, customs and beliefs play an important role in shaping institutional changes.

Consequently, considering that 'development' is contextual; this framework adds two more concepts that increase the possibility to collect extensive circumstantial evidence. These are interest groups and international relations. Unlike earlier concepts, these new concepts do not have a theoretical analysis, but rather introduce an initial idea for the Ecuadorian case.

➤ **Interest groups**

In Ecuador, the interest groups influence economic and political outcomes through time. These are the church, agrarian elite, the military, political parties, business society, transnational corporations, urban and rural working class, middle class, among others. Indeed its participation level and influence could be explained by the period in which they developed.

Certain groups have established alliances with less influential groups in order to gain more power. These groups have not promoted national development because their concern has been the private accumulation. In this regard, the interest groups can interrupt institutional changes for their own benefit (Vasconéz et al, 2005)

The changes of beliefs directly influence the decision of interest groups. Since they could choose to keep or change certain institutions in order to obtain the desired results (Alston et al., 2013). So, these new beliefs should modify the bad customs of interest groups and thus divert their personal interests towards community interests.

➤ **International relations**

International relations have focused primarily on the United States. On one hand, the relationships are based on mutual interests focused on maintaining democratic institutions, investment, infrastructure, financial ties, etc. On the other hand, U.S repeatedly forces to Ecuador to accept their conditions through diplomatic pressure and non-peaceful actions.

During certain governmental periods the relations with United States were stronger in comparison with others. For example, during the government of Rodrigo Borja (1988-1992) international relations were more diversified, it included developing countries, Western Europe, socialist countries and multilateral organization (U.S. Library of Congress, 2014). Conversely, in the current government the relations with U.S have weakened due to several conflicts related to immigration, drug issues trade relations and attacks to sovereignty (Ponce, 2004).

5. Development of ‘Analytical Narratives’

Case Study: Ecuador, 1950-2014

Considering the conceptual framework, this section analyzes Ecuadorian economic history since the 50s, stressing that this country broke with its past. The interaction of concepts is crucial to understand the way beliefs and institutions evolve in order to establish the start of a new trajectory.

The complete historical period is divided into three stages; first: 1950-1979, it was characterized by agricultural booms, constant struggles between powerful groups and dictatorships; second: 1980-2006, it was centered on the return of democracy, oil boom and several economic and political crises. The third and final period: 2007-2014 represents the break with the past characterized by changes in beliefs, institutions and outcomes.

5.1. The Extractive Economy: An Endless Story, 1950-1979

The Problem of Limited Economic Prosperity

Since the early 50's, Ecuador experienced a profound economic change based on banana boom. This country exploited its comparative advantage obtained by bad weather conditions and pests in Central America. As a result, the exports rose dramatically due the strong links with international markets, mainly United States and Europe. This external demand was fundamental to sustain the banana boom (Montalvo, 2013).

The economic prosperity revitalized the domestic market and transformed the coastal agricultural region. To some extent, this boom brought better conditions for workers, thus it introduced the concept of agricultural wage labor that did not exist before the 50s. In

addition, the banana boom with demographic pressures prompted the emergence of an urbanization process (Espinosa, 2010). The next table shows the growth rate of Ecuadorian population during the period 1950-1962. The urbanization process is explained by the high rates of urban population. Certainly, the rural population abandoned its territory in order to move to more productive areas, such as Coast and Amazon.

Table. No. 1
Growth Rate Population, 1950-1962

	Country	The Highlands	The Coast	Amazon	Galapagos Islands
Total Population	2,95	2,09	4,11	3,98	4,79
Urban Population	4,73	3,56	5,89	5,23	-
Rural Population	2,12	2,37	3,10	3,79	4,79

Source: Ayala, 1990.

Concerning the international relations, United States financed the production and marketing of bananas during the boom. This country helped Ecuador to overcome its difficulties. At first glance, this aid seemed adequate, but in reality it constituted another mechanism to strengthen external dependence (Acosta, 2012). There is no doubt that the U.S has helped Ecuador many times, but it also has plunged the country into underdevelopment due to its capitalist relations.

The next sections will indicate that economic prosperity brought many positive results, including strengthening of domestic market, urbanization process, improved road network, expansion of agricultural frontier, etc (Acosta, 2012). But, the existence of powerful groups unbalanced the profit distribution in the society. While exporters earned the most of income, the workers and producers together received only slightly more than half of the national value added. These facts contradicted the positive outcomes; therefore Ecuador did not overcome the substantial problems of underdevelopment. This country was led by extractive institutions that only favored minority groups.

➤ **Industrialization Process through Modernization Theory**

Latin America including Ecuador undertook the challenge towards development through the establishment of the import substitution model (ISI model). The Economic Commission

for Latin America and the Caribbean (ECLAC) was directly responsible for their promotion and establishment (Naranjo, 2005).

The ISI model represented the Latin American version of 'Modernization Theory' taken from developed countries. It was focused on industrialization as the solution to achieve development through sustained economic growth. Thereby, the *new development thinking* was against the primary exporting models due to its inability to generate value added, high income concentration in minority groups and high dependence on international market fluctuations (Correa, 2014).

In Ecuador, this model did not have the expected results due to poor national situation (decline of the banana boom at early 60's) and the inability of elites to achieve their objectives. In this respect, the domestic market was not boosted, the wealth and income were not redistributed, the flow of capital was not guaranteed and tariff policy was not adequate to drive the industry.

➤ **Role of Government**

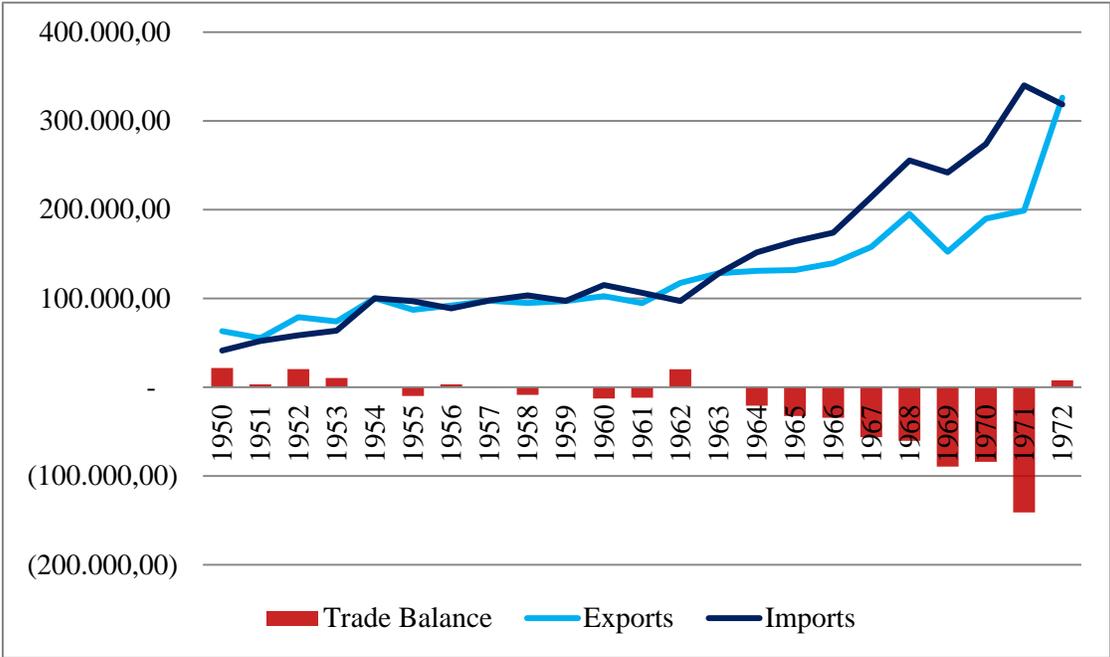
The ISI model promoted an active State role, mainly in planning and promotion of investments in strategic sectors. Nevertheless, in 1954, ECLAC through the report called "The Economic Development in Ecuador" stated that Ecuadorian government failed to lead the process of active intervention in economic activity due to instability of their institutions and the weakness of entrepreneurial economic system (Mayoral, 2009)

To solve that problem Ecuador introduced a planning process by the creation of a control organization called 'Planning Board' that was created to advise the government about development plans with economic coordination⁸ (Moncada, 1974). Regarding economic policy instruments, the government ordered a devaluation to increase export profits and competitiveness. It transferred export revenues to other economic areas, thus it increased public investment, especially in road networks that favored national integration, the development of major cities and the emergence of middle classes (Hurtado, 1997).

⁸ The ECLAC studies influenced the creation of such plans, particularly: 'Plan for Economic and Social Development 1964-1973' and 'National Plan for Transformation and Development 1973-1977'(Correa, 2014)

Regrettably, the effects were not always positive, the infrastructure investment increased dependence on imports of capital goods that caused deficit of trade balance. The Graph. No. 1 shows that the terms of trade declined and caused huge instability in international markets from 1955. These difficulties reached a critical level in the mid-60s, so from 1964 the trade balance turned negative until 1971. Imports grew significantly compared to banana exports (Acosta, 2012). As a consequence, once again the international companies concentrated its demand in Central America since this region overcame its problems concerning plagues and diseases.

Graph. No. 1
Trade Balance, 1950 – 1972
Millions of dollars



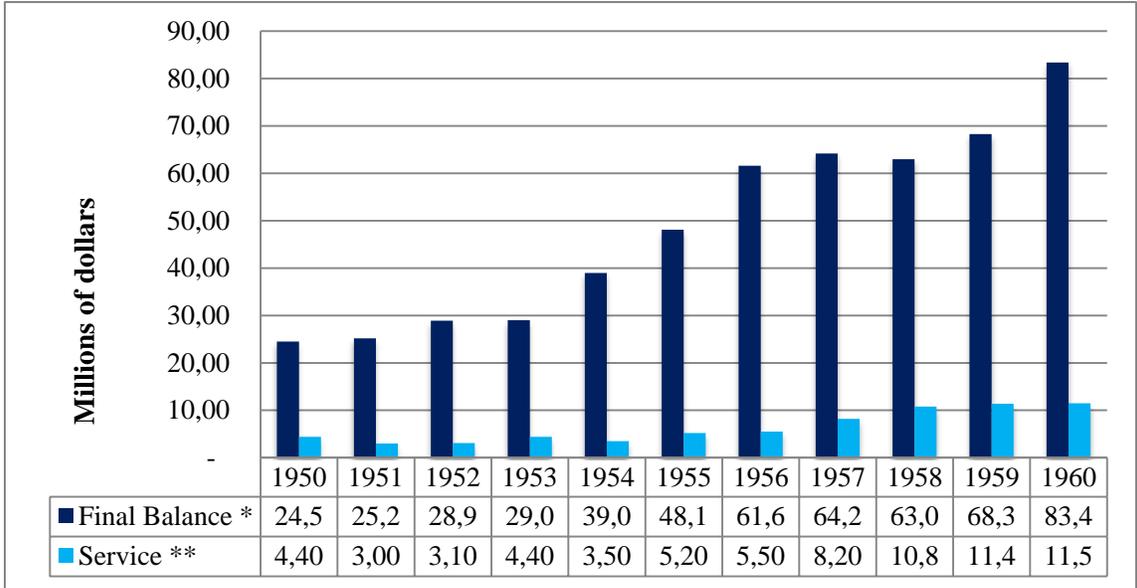
Source: Central Bank of Ecuador, Monthly statistical information, 1995

➤ **External Debt**

In 1953, Ecuador was able to renegotiate its foreign debt due to abundant economic resources derived from banana boom. This debt grew to 83.4 million at the end of the 50's. But, this growth was moderate considering the limited ability to pay and the low level of foreign capital.

In this sense, the Graph. No. 2 indicates the upward trend of external debt that almost quadrupled in this decade. The large infrastructure investments caused problems for debt payment, though these public works were necessary, it increased the benefits of elite, so it negatively impacted to the society.

**Graph. No. 2
External Debt, 1950 – 1960**



Source: Acosta, 2012

* Final balance = initial balance + payments + adjustments for exchange rate variation - amortization.

**Includes amortization and actual interest.

➤ **Another attempt to industrialize through Agrarian Reform**

The military junta ruled Ecuador during the period 1963-1966, this government promoted social and economic order, since they wanted to modernize capitalism through the implementation of the 'Alliance for Progress'. It was a program of economic, political and social aid created by United States for Latin America.

This government fostered the 'Developmental State Model' centered on increasing external revenues and industrialization. Since 1964, the government continued to invest in road networks, mainly in the regions of high economic activity. In the same year, the first Agrarian Reform was established to alleviate pressure on land and solve the problem of low productivity (Gondard & Mazurek, 2001). Although its impact on land distribution was limited, the Agrarian Reform eliminated precarious forms of work, particularly the

institution of hacienda called 'huasipungo'⁹. This reform boosted the industrialization process through low prices of raw materials, primarily for urban areas.

At this stage, two major groups of interest influenced this process, so the Catholic Church and the landowners divided their haciendas in order to prevent loss of power and continue profiting from their productive activities.

As a consequence of industrialization, the agriculture lost significance. To solve this problem, the Government proposed several projects of land reform in order to encourage the expansion of livestock and modern production. Despite the efforts made, the military government did not achieve the expected results concerning modernization and national development. They failed to address social demands. Once more, the country was going through high economic, social and political instability. Also the income distribution was inexistent, only the minority groups were benefited above most of the population. And, the poverty was very high, especially in rural areas.

➤ **The Emergence of a new 'Extractivism'¹⁰: The Oil Boom**

The hydrocarbons potential of Ecuador began to attract the attention of transnational corporations that were looking for new oil sources worldwide. Ecuador once again opted for the exploitation of resources due to external needs and not for domestic reasons. The oil exports caused rapid economic growth that improved the productive structure of the country. Thereby, it eased negative effects caused by the decline of banana production, and political conflicts between dominant groups from the Sierra and Coast (Bocco, 1987).

Furthermore, the strong presence of 'dictatorships' shaped the oil era during this decade. José María Velasco Ibarra was proclaimed dictator in 1970 after democratically govern for three years (1968 -1970). He was overthrown by a military coup in 1972 and Guillermo Rodríguez Lara replaced him as dictator.

Definitely it was the end of an era for the beginning of another. The historical disappearance of 'Velasquismo'¹¹, implied leaving behind the characteristics of a country:

⁹ Huasipungo is a piece of land that the landowner gave the Indians in exchange for agricultural work.

¹⁰ It explains the way of organizing a country's economy, based on the exportation of commodities such as fossil fuels, minerals and agricultural products.

closed geographically; culturally rural; poor and socially lagging; and closer to autarky than to development (De la Torre, 1993).

During the 70s, Ecuador strengthened the 'Developmental State Model' that was implemented by the Military Junta in the 60s. This model was based on 'ECLAC features', thus the country was commercially opened through the ISI model and industrialization (Ramos, 2013). In addition, for the first time in history the Ecuadorian Government obtained autonomy with regard to powerful groups, mainly: exporting firms.

Therefore, the domestic market grew significantly while the old social and cultural patterns were extinguished. The State involvement and new economic growth areas caused an increase of workforce and the emergence or strengthened of dominant groups: the 'golden bureaucracy'¹², and the 'middle class'. The social opportunities increased due to the huge economic revenues obtained from petroleum.

As a result of high revenues in the industrial sector, the population migrated from rural areas to major cities (Quito and Guayaquil). These factors contributed with past urbanization process and the increase in labor market (Espinosa, 2010). Accordingly, the Table. No. 2 indicates the growth rate population, confirming the urbanization process.

Table. No. 2
Growth Rate Population, 1974-1982

	Country	The Highlands	The Coast	Amazon	Galapagos Islands
Total Population	2,52	2,23	2,54	4,94	4,91
Urban Population	4,48	4,06	4,68	10,84	7,62
Rural Population	0,91	0,93	0,33	3,70	(0,30)

Source: Ayala, 1990.

These changes were misperceived in the 'modernization theory' that asserted that development is associated with high levels of urbanization (Correa, 2014). Ecuador had the conditions to be considered an urban society, but it did not reflect the serious economic,

¹¹ Velasquismo refers to periods in which Velasco Ibarra took power in Ecuador. The government periods were: (1934-1935), (1944-1947), (1952-1956), (1960-1961) and (1968-1972).

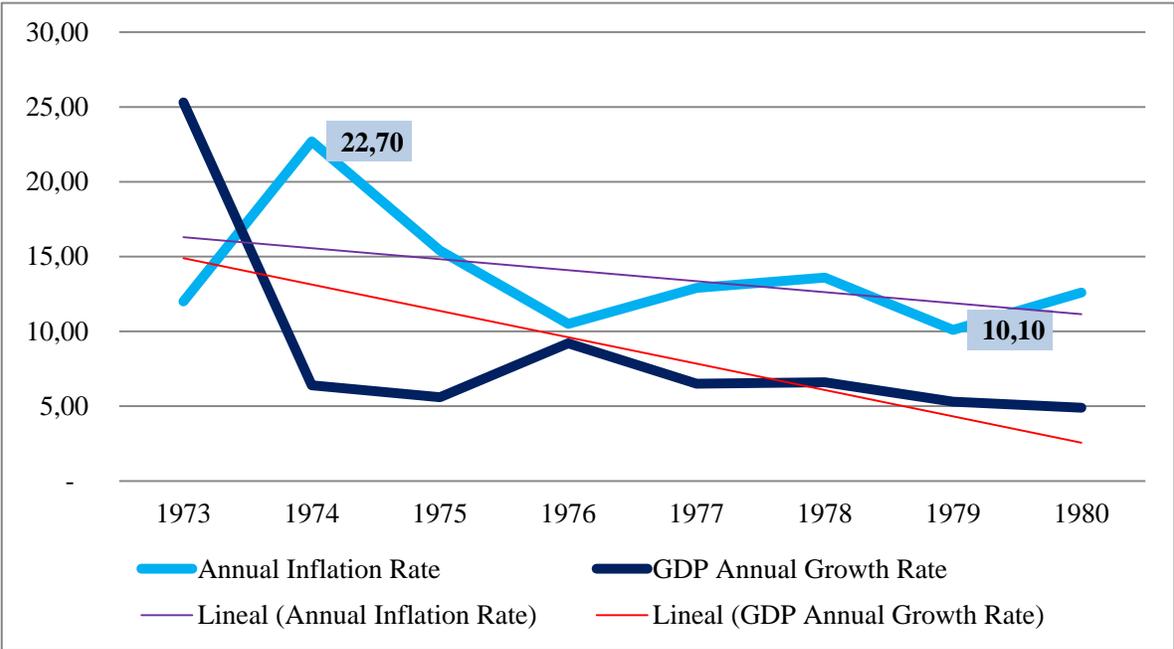
¹² It refers to sectors with privileged wages that produce conflicts and endurance with other bureaucratic groups.

political and social obstacles bedeviling the country. The concept of development involves many other factors that create lasting institutional changes and further establishes certain beliefs that transform societies.

The country experienced some problems in manufacturing sector that hindered jobs generation. So, unemployment and underemployment increased and new forms of poverty appeared. Contradictorily, all negative consequences occurred in the period of greatest wealth of Ecuadorian economy.

Besides, the military triumvirate promoted trade liberalization and prioritized the inflation control, which fell from 23% in 1974 to 10% in 1979 (Mayoral, 2009). Regarding the relationship between GDP and inflation, the next graph indicates the historical evolution of these indicators over the period 1973-1980. Clearly, both trends are decreasing, reflecting two important events. First, the reduction in the inflation rate confirms the State's concern to reduce this indicator. Second, the downward trend in GDP shows some economic instability despite inflation control.

Graph. No. 3
GDP vs. Inflation, 1973 – 1980
Percentages (%)



Source: Central Bank of Ecuador, 1997.

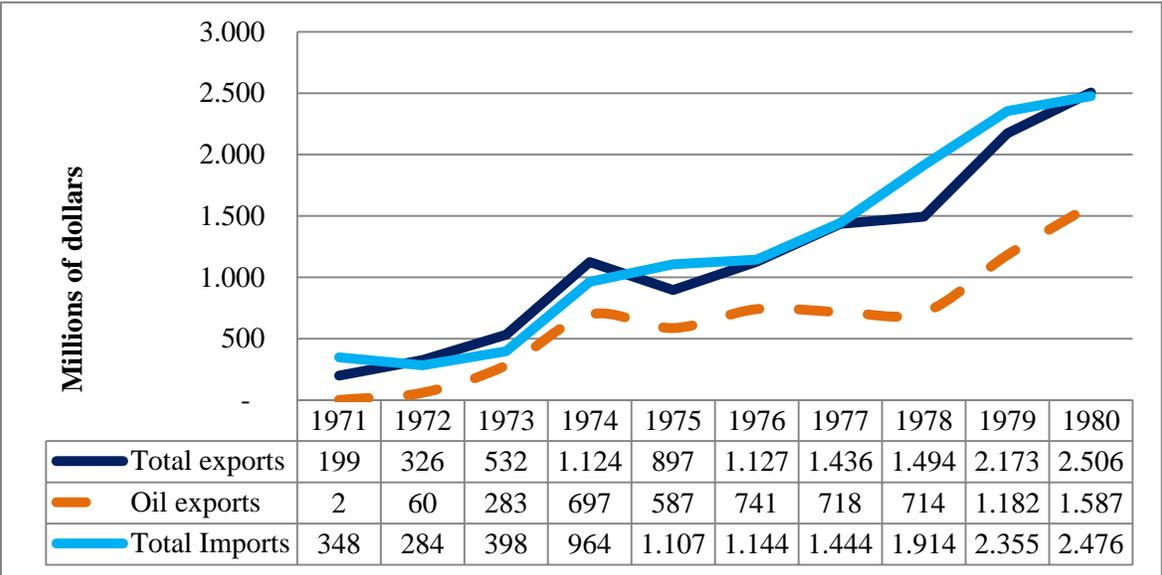
In short, the 70s were marked by an enormous instability and poor living conditions, such as: bad road networks, poor energy service, lack of capital and technology, high levels of illiteracy, poor distribution of social wealth, corrupt governments, among others (Ramos, 2013).

➤ **Important Facts & Figures that showed the start of new era**

During the whole decade (1971-1980) due to petroleum, the total exports amount grew from \$199 million to \$2.506 million. This trend increased over time and it showed the huge significance for its economy (Ramos, 2013). In the case of imports, these grew from \$348 million to \$2.476 million in the same period. In this regard, Ecuador did not have a real process of import substitution; rather it was a process of reproduction of imports that caused an overvaluation of national currency.

The Graph No.4 indicates that exports and imports grew at approximately the same rate. But, there are periods when imports exceed exports, showing a high dependence on imports of capital goods.

Graph. No. 4
Exports and Imports, 1971 -1989

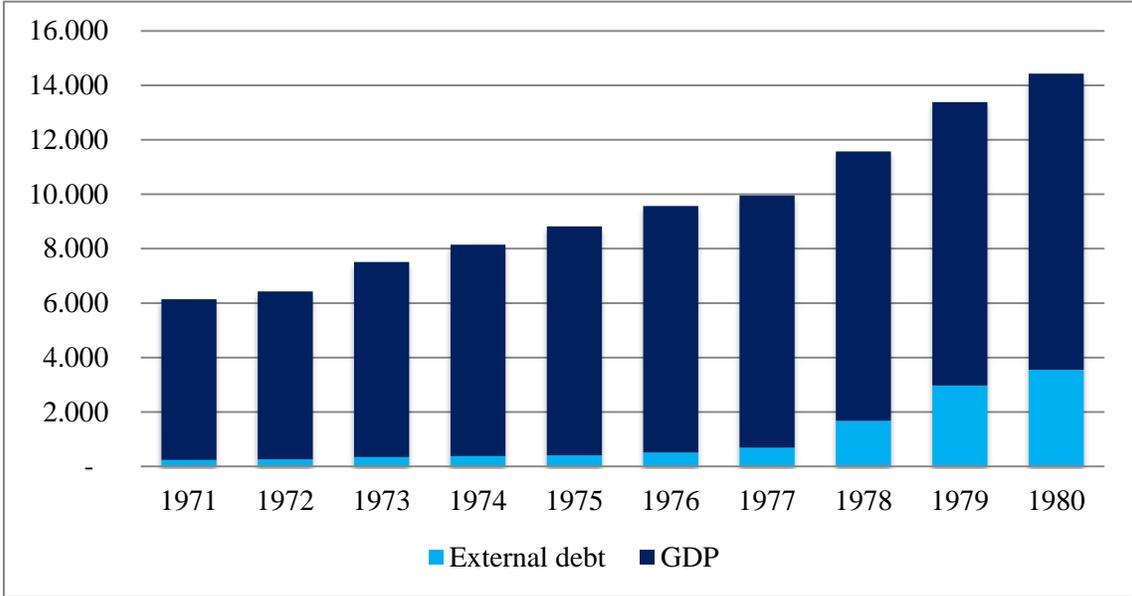


Source: Ramos, 2013

Since 1972, Ecuadorian government won many petrodollars¹³. These economic resources were used irresponsibly because the State increased social spending; public investment and urban consumerism without consider the future consequences. As a consequence of this reckless behavior, the government resorted to external financing to solve the problems of high expenditures. Indeed, since 1976, Ecuador and other Latin American countries began a period of "aggressive borrowing"¹⁴. This process was led by international and multilateral lending agencies to regularize the excess liquidity in developed countries (Naranjo, 2005).

External debt increased significantly, mainly in the second half of the 70s. Specifically, in 1971 -1975 the external debt/GDP ratio accounted for 4.4%, this proportion remained steady for some years. Nonetheless, during the oil boom the figures had changed, in 1976 that percentage rose at 5.7%, in 1978 it increased to 16.9%, and in 1979 this ratio increased at 28.6% (Ramos, 2013). The following graph shows the dramatic rise of external debt over the period. Also, it can be seen the start of 'aggressive borrowing' since 1976.

Graph. No. 5
External debt, 1971 – 1980
Millions of dollars



Source: Central Bank of Ecuador, Monthly statistical information

¹³ U.S. Dollar earned through the sale of oil.

¹⁴ This term refers to debts incurred by the irresponsible rulers in the 70s; these debts grew unceasingly and created a huge instability in Latin American countries.

➤ **A Closer Look to the Core Concepts**

To better understand the facts and circumstantial evidences described above, it is necessary to specify the dominant belief and interaction of the key concepts found over the period 1950-1979.

To start is essential to explain the legacy of Spanish colonization in Ecuador (XVI century), since the economic performance reflects the institutional characteristics inherited since those times (Acemoglu et al., 2005). The colonization led to the establishment of a hierarchical society in which white people and people of color were separated by deep economic and social differences. It was impossible to change the place in social scale and the living conditions. The citizens took for granted their reality and unfortunately they did not have the power to change it. Thus, the social hierarchies implanted the belief in permanent social status. This belief restricted property rights and equal opportunities for all individuals.

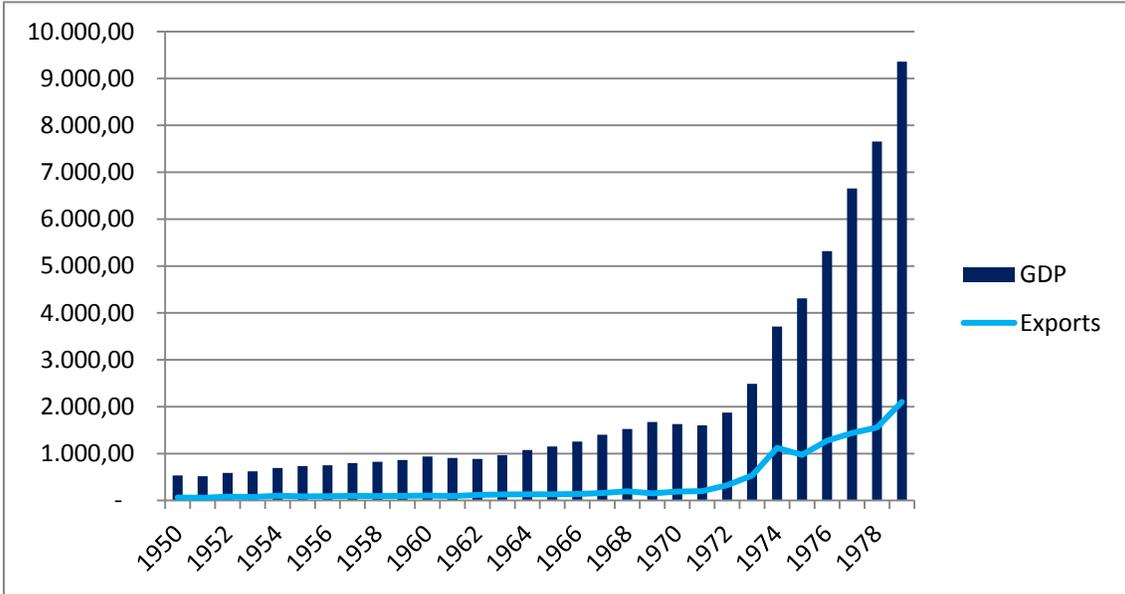
Thus, the beliefs and customs of Ecuadorians were characterized by little interest in economic progress. The country did not have appropriate institutional arrangements, such as respect for property rights and enforcement of rules and regulations (Hurtado, 2013). As a consequence, the customs and the dominant belief restricted social welfare, business progress, and national development. These were some of the direct outcomes of the belief in permanent social status. The people did not strive to change their lives, because they believed that inherited social status could never be changed.

Nevertheless, since 1950 the dominant beliefs and customs changed as a result of the expansion of entrepreneurship in coastal areas by the banana boom. Economic, political and social changes contributed to the increase of interest in the work and rent seeking. Definitely this time was characterized by strong cultural change that was promoted by economic growth resulting from the banana and oil exports.

The period 1950-1979 represented three consecutive decades of impressive economic growth, which transformed all orders of national life. So Ecuador left the group of the most backward countries in Latin America. This era was characterized by high economic prosperity, agricultural improvement and strengthening of physical infrastructure. As an

illustration, the Graph No. 6 indicates the relationship between GDP and exports. The GDP increased significantly, thus it demonstrates the continuous economic growth in the period. Similarly, the exports grew largely and this reflects the relevance of the extractivism in Ecuadorian economy.

Graph. No. 6
GDP vs. Exports, 1950 – 1979
Millions of dollars



Source: Central Bank of Ecuador, 1997.

The dominant belief in permanent social status disappeared as a result of economic progress and the consequent improvement of living conditions, such as the spread of social services. Moreover, political parties and coalitions promoted laws and reforms aimed at correcting unfair economic and political relationships. But often these ideas hampered national development due to conflicts between interest groups (Hurtado, 2013).

In the 60s, ECLAC and the 'Alliance for Progress' promoted structural reforms focused on strengthening government participation to achieve development and redistribution of wealth. Additionally, the elimination of 'huasipungo' and Agrarian Reform improved the living conditions of peasants.

The State through the Planning Board established favorable conditions for national development through planning, projects implementation, public investment, business

formation, institution building and implementation of protectionist measures. These events were promoted by the State autonomy, as a consequence of oil revenues (Hurtado, 2013).

In addition, the 1979 Constitution instituted the regime of political parties, which prioritized their ideology and program principles. This formal institution put an end to the dictatorships era. Moreover, this Constitution promoted national rights, including the vote for illiterates, thus a type social discrimination was eliminated, and the society was revalorized to some extent.

The social behavior changed, as an illustration the peasants wanted to get the most out from their land to improve their life quality. As a consequence, a new belief emerged, that was the belief in personal and national development. This belief arose as a result of the importance of this concept, the relentless pursuit of enrichment and the application of 'Developmental State model'. Besides it was the outcome of change in customs due to the economy prosperity for three decades. This belief contributed to the expansion of the virtuous circle of economic growth, in which some people escaped poverty. But, it did not eliminate the problem of social differences.

The creation of the 'Planning Board' in 1954 established a window of opportunity because beliefs of the leaders changed when they gave prominence to the state planning. In addition, the economic environment was conducive to promote better outcomes through the emergence of new belief in personal and national development. The citizens wanted to improve their lifestyle and worked to get the most benefit, unfortunately the leadership was not sustainable and the window of opportunity was wasted.

Furthermore, some governments in this period had a populist ideology centered on demagogic speeches and unrealistic promises. According to (Ayala S. , 2014), populism is the shortcut to economic prosperity, but it never works. Consequently, democracy was absent due to strong presence of dictatorships in the 70's. Also, interest groups hampered development because of the desire for absolute power without considering social welfare.

The international relations with U.S through the 'Alliance for Progress' increased external dependence and the country entered into the most aggressive stage of indebtedness. Thus, in the late 70s, the belief in personal and national development faded, mainly due to

declining booms and the absence of democracy. The unfavorable conditions, bad customs and the disappearance of the dominant belief limited the Ecuadorian development, likewise the lack of leadership and the existence of antagonistic interest groups overshadowed the richest time in Ecuadorian economy.

5.2. The Return to Democracy for misconceived reasons, 1980 -2006

This period started with the return to democracy, but this regime arose for the wrong reasons. The bourgeoisie was concerned about the protection of their interests, because modernization led by authoritarianism weakened its dominance in the country. Thus, elites chose democracy as the best way to restore its power and its political influence in Ecuador. As a result, Ecuadorian governments were corrupt and extremely indifferent to economic and social problems (Naranjo, 2005).

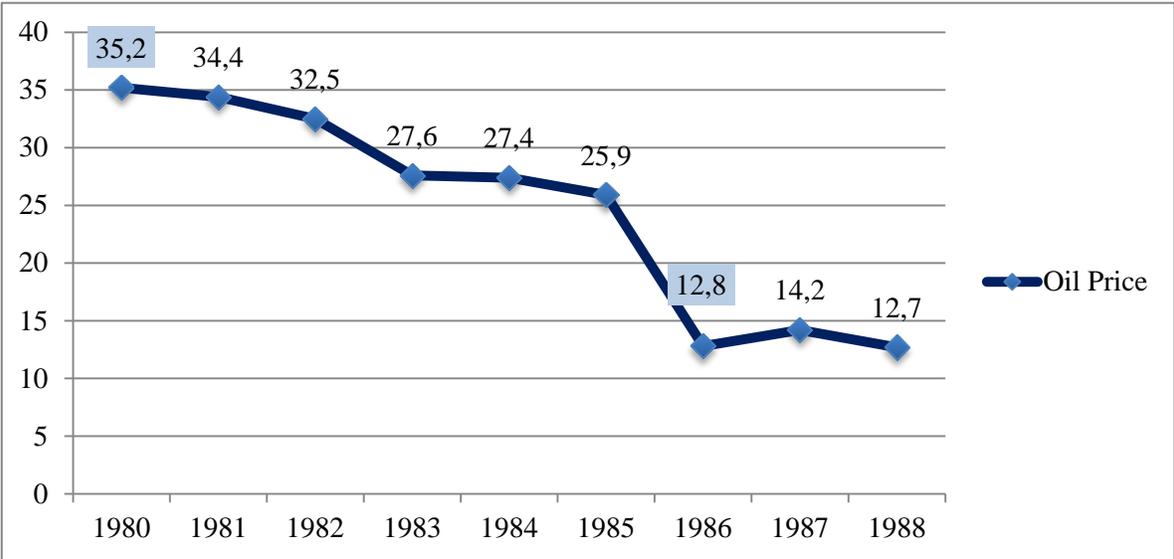
Jaime Roldós inaugurated a new democratic era in Ecuador as the first elected president after several dictatorships. Still, the return to democracy was strictly controlled by the armed forces. The legitimate democracy 'by and for' the people was far from being achieved due to lack of political commitment. Then, the situation worsened by the continuous dispute between the three branches of government, political party fragmentation and regionalism. To solve this problem, Roldós tried to build a reorganization process through the establishment of a new progressive Constitution. As noted in the last period, the 1979 Constitution promoted civil liberties and emphasized the transformation of Ecuadorian democracy to consolidate the country's institutionalization.

Further, Ecuador began a process of greater international integration through the establishment of stabilization and adjustment policies within the mainstream of 'neoliberalism'. These policies were based on an enterprise development model, so the market was quite important in the economy. These measures were established and deepened during the period 1981-1996 (Ayala & Fernández, 1995).

Concerning external shocks, the delimitation of frontiers between Ecuador and Peru was considered a serious national problem since it triggered short wars between them in the years 1981 and 1995. It generated high public spending on national defense, weak trade relations with Peru, and even worse several material and human losses.

Moreover, Ecuador suffered the effects from international crisis in the 80s. The governments of developed countries implemented some contractionary macroeconomic policies that caused deterioration of exports. As an illustration in 1980 the price per oil barrel cost \$35.2, this figure fell sharply in 1986 in which the price per barrel fell to \$12.80. The next graph illustrates the downward trend of the oil prices. This fact negatively affected to Ecuadorian economy since it was highly dependent on oil exports.

Graph. No. 7
Oil Prices, 1980 – 1988
Export price (US\$ per barrel)



Source: Central Bank of Ecuador.

The economic downturn in Latin America was not only a consequence of the international factors. Their governments applied several economic policies that caused a rise of external debt. The external economic resources were aimed to finance an irresponsible domestic spending. Specifically, monetary policies negatively impacted investment and consumption due to high interest rates. And, price stabilization policies affected investment and trade balance (Pacheco, 1985)

During the 80s, Ecuador entered into a recession period caused by the decline of oil boom and the disruption of international credit. This crisis was deepened by external shocks, such as the strong winter in 1983 that destroyed the coastal agricultural production, and in 1987 a great earthquake damaged the Ecuadorian pipeline. The last event weakened exports and this stopped for six months the oil industry (Ayala E. , 2008).

In 1983, the burden of external debt was exacerbated by the application of the 'sucretization'. It represented a direct subsidy granted by the government to the private sector. In other words, the Ecuadorian State assumed private debt to protect the labor sector of these enterprises. But conversely it brought some negative consequences to the country (Acosta, 2008).

Since 1984, through neoliberal policies, the government of Febres Cordero built an enterprise development model based on interests of private business. Also, this government eradicated industrialization through trade liberalization and the elimination of the institutional framework that supported ISI model. This government had several conflicts with opposition groups, who reported numerous cases of government corruption and human rights violations. Consequently, the State used coercive force to stop the protests, but it violated the Constitution by strong abuse of power (Roldós, 1986).

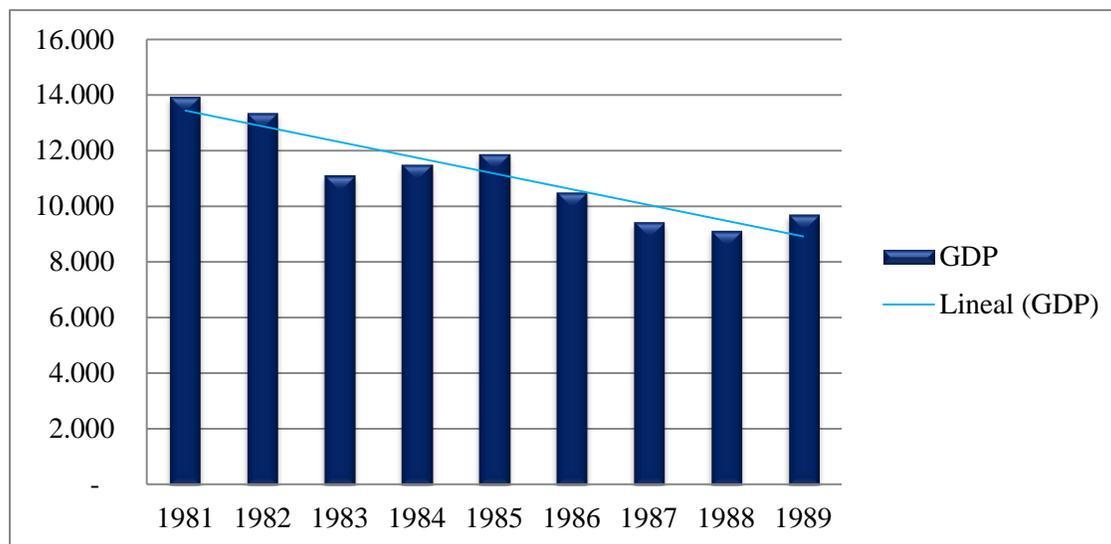
In 1988, a new government led by Rodrigo Borja, took the same neoliberal tendency to rule the country. He proposed a several reforms to liberalize the market and boost labor sector. But, it failed to perform the proposed socioeconomic changes, despite the power domain in Congress, Supreme Court and control agencies. In this sense, he had enough power to overcome some national problems. It was not a window of opportunity, but Borja could have achieved a significant national progress. However, this president wasted this chance.

Referring to outcomes, this government brought positive and negative results, such as integration to international market, implementation of guarantees of freedom for expression and human rights and the application of several social programs. Conversely, external debt grew; the cost of living worsened and weakened the productive apparatus.

➤ **Facts & Figures that showed the Severe Effects of the Crisis**

During the period 1981-1990, GDP dropped 18%, thus GDP per capita decreased by 5.7%, receding to the same levels of the mid-70s. In real terms, the GDP fell from \$14.000 million in 1981 to \$9.000 million in 1989 (Correa, 2014). The Graph No.8 indicates the downward trend of this indicator.

Graph. No. 8
GDP, 1981-1989
Millions of Dollars



Source: Acosta, 2012.

Ecuador experienced one of its worst crisis determined by rapid growth of poverty levels and strong social polarization due to income deterioration. Furthermore, the growth of the urban labor supply was worsened by the lack of sector dynamism, reflected in high levels of unemployment and underemployment (Pita, 2000). In 1990, only 44% of the workforce had a decent job, while 6% of the economically active population was unemployed and 50% were underemployed. The table No. 3 shows how the crisis affected the labor market in Ecuador, thus unemployment and underemployment rose to substantial figures.

Table No. 3
Underemployment and Unemployment, 1980-1999
% of Economically Active Population

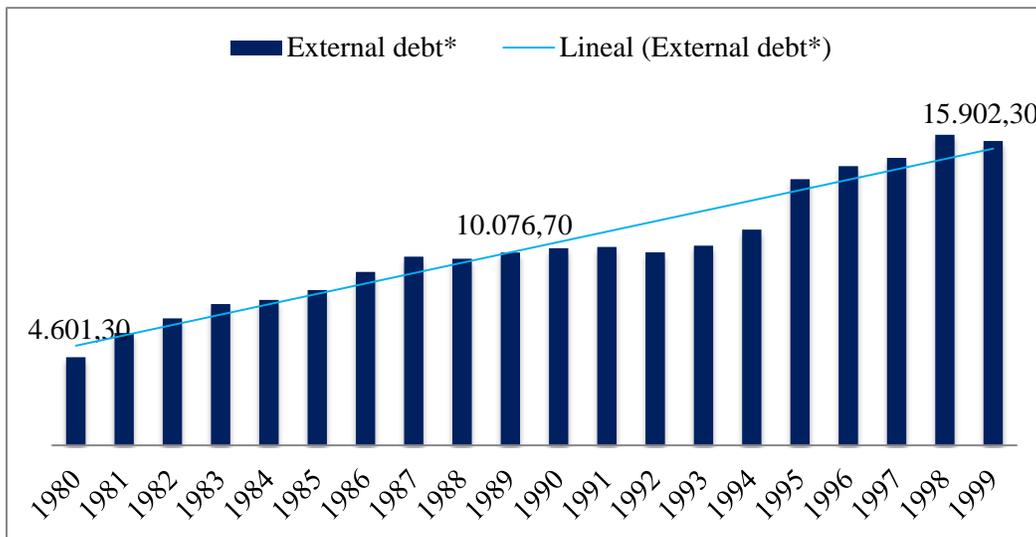
Year	(% EAP)
1980	35,2
1981	40,1
1982	44,5
1983	49,5
1984	48,1
1985	52,5
1986	56
1987	51,3
1988	48,5

Year	(% EAP)
1989	49,4
1990	55,9
1991	62,8
1992	56,8
1993	55,5
1994	53,6
1995	52,8
1996	53,8
1997	50,5
1998	54
1999	62,9

Source: Naranjo, 2005

Moreover, the external public debt rose to unprecedented levels, increased from \$4.600 million in 1981 to \$15.900 in 1999, it was the result of refinancing and capitalization of interest arrears (Acosta, 2012). The oil boom and external debt did not generate the expected structural changes that were intended to create the basis for sustainable development in Ecuador. Indeed, Ecuador became more dependent on international resources. The Graph No. 9 shows the evolution of Ecuador's foreign debt in the crisis period that was dramatically increasing.

Graph. No. 9
External Debt, 1980 – 1990
Millions of dollars



Source: Naranjo, 2005

* Final balance of the debt + interest

Referring to social spending, Ecuadorian population had experienced remarkable improvements in their standard of living during the 70s and the first half of the 80s as a result of the oil boom. But since the late 80s and early 90s, public investment in social areas decreased, coinciding with the most difficult stages of external debt and fiscal issues (Naranjo, 2005). The following table shows that public investment has not increased over time. In fact, it has remained almost constant with slight decrease in some years, so in the entire period this figure was approximately 4% in education and culture, and 1% in health and community development.

Table No. 4
Public Investment (% of GDP), 1986-1999

Year	Education and Culture	Health and Community Development
1986	4	1,1
1987	3,9	1,4
1988	3,3	1,3
1989	3	1,2
1990	2,7	1,2
1991	2,9	0,9
1992	3,1	1
1993	2,6	0,7
1994	2,9	0,9
1995	3,3	1,1
1996	3,2	1,2
1997	3,5	1
1998	3,2	1
1999	3,8	1,2

Source: Naranjo, 2005

➤ **The Problem of Unstable Governments**

In the early 90s, the country followed the same economic trend of the 80s: 'neoliberalism'. It was centered on economic policy proposals promoted by Washington Consensus. Also, this period was characterized by strong influence of U.S government and transnational corporations (Falconí & Oleas, 2004).

Indeed, Washington Consensus was the second economic model that replaced Import Substitution model. Within this framework, the structural reforms were focused on trade liberalization, minimum role of the State and strong promotion of market measures (Laferriere, 2003). But the adjustment measures of this model provoked unexpected outcomes such as: high levels of poverty and social exclusion, macroeconomic imbalances, low per capita economic growth, trade deficit, institutional failure and unequal wealth distribution. These results reinforced exclusionary and concentration tendencies.

These results were part and consequence of an institutionalism sustained on paternalism, rent-seeking, corruption and impunity. Many studies show that the adjustment policies constituted aspects of social instability because these did not consider democracy and distributional factors (Páez, 2000).

At that time, the 'individualism' became a high virtue, 'competition' in mode of life and the 'market' in a strong driver of people and societies. Any planning programs or collective actions were rejected (Correa, 2014). In this context, the belief in culture stability was imposed to counter the desire for social change.

In 1994, the Agrarian Development Law was imposed to fix the problems of previous reforms. This law discouraged precarious forms of land access and it also reinforced property rights (Cabrera, 2008). Nevertheless, it failed in the redistribution of land ownership among the underprivileged. Once again, these kinds of reforms benefited to minorities. Besides, in the same year, the General Law of Financial Institutions liberalized banking business. It is important to highlight this fact since it represented the main cause of the 1999 crisis.

In 1998, a new constitution promoted the recognition of collective rights of indigenous people. Therefore, indigenous people through the formation of the 'Confederation of Indigenous Nationalities of Ecuador (CONAIE)' obtained wide recognition in the country, so they started to participate in the politics (Sánchez J. , 2007)

In 1999, during the presidency of Jamil Mahuad (1998-2000) Ecuador experienced the greatest financial crisis in its history. It was caused by the enactment of the General Law of Financial System in 1994, which eliminated control and supervision on financial

institutions, emphasizing self-regulation. But these actions only caused deregulation (BCE, 2008). In general, the causes of the financial crisis were lack of control to bankers, liberalization of capital flows, and devaluation of national currency (Mayoral, 2009). Also, some of its triggers were financial irresponsibility, lawlessness and corruption.

As a logical consequence of the imposition of ‘neoliberalism’ and the crisis; a new belief arose in the country and was called 'economic terrorism'. According to (Acosta & Schuldt, 2000), this term refers to the action of any person, institution or media to disseminate information lacking empirical verification. Such actions leads people to make decisions that transform a rumor into truth, based on speculation.

Within this context, the worst consequences of the crisis were directed to social issues, such as the rapid impoverishment of the population and the high concentration of wealth. The Table. No.5 indicates that in 1990 the poorest 20% received 4.6% of revenue, whilst in 2000 the same segment of the population received less than 2.5%. By contrast, the richest 20% increased its revenue collection from 52% to 58%.

Table No. 5
Share of Total Income (%), 1990-2000

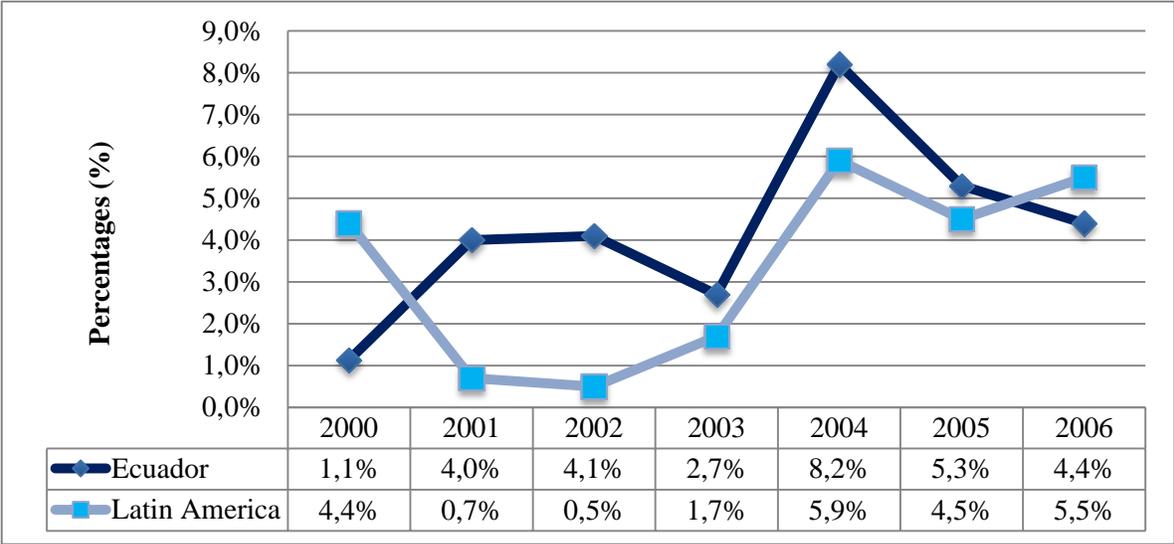
Year	The poorest 20%	The richest 20%
1990	4,60%	52,00%
1995	4,10%	54,90%
1999	2,46%	61,20%
2000	2,10%	58,00%

Source: Central Bank of Ecuador, Monthly statistical information.

In early 2000, the 'dollarization' was imposed in Ecuador as a solution to the crisis. This process was sustained by several sources, such as remittances and high international oil prices. Consequently, the post-dollarization period (2000-2006) was determined by political instability reflected in frequent changes of government. The institutional structure was negatively affected because of the lack of State commitment to overcome the crisis. The bad outcomes emerged briefly, so uncertainty and social divergence rose to critical levels.

The Graph No. 10 indicates that despite political difficulties, Ecuador started to grow at real rates above 4% (except in 2003), a high percentage compared to Latin America average. It was part of the recovery process, nevertheless, economic growth was considered weak and erratic. Moreover, in 2005 Ecuador achieved price stabilization but it was not enough to recover its economic stability.

Graph. No. 10
Growth Rate*, 2000-2006

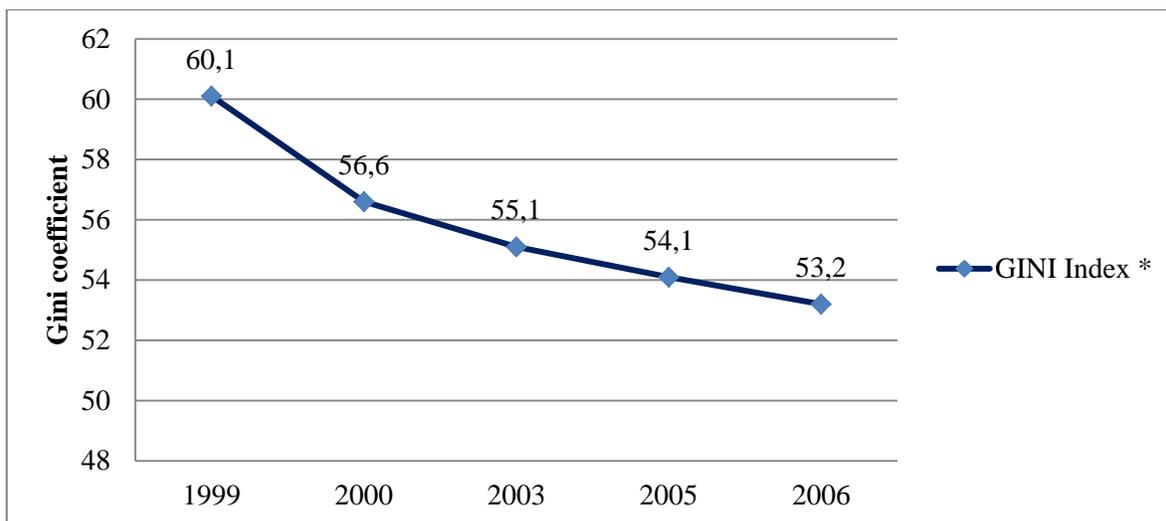


Source: ECLAC, Economic Indicators and Statistics.
* Total Annual GDP at constant prices

Regarding inequality, the Gini index fell about 3.5 percentage points; that is from 60.1 in 1999 to 56.6 in 2000, as a result of the recovery phase after the 1999 crisis. But after 2000, the drops in inequality had not been substantial. Thus, Graph No. 11 shows a slight improvement over the period, that is a modest reduction of 3.4 percentage points but in 6 years.

Similarly, the income gap has experienced a slight reduction, so the differences between rich and poor remain large. For instance, in 2000, the poorest 20% of the population received 3% of income, while the richest 20% of the population received 60.8%; whereas, in 2006, the poorest 20% of the population received 3.6% of income, while the richest 20% of the population received 57.7%. The Graph No. 12 presents the changes in inequality as measured by the distribution of income among population quintiles.

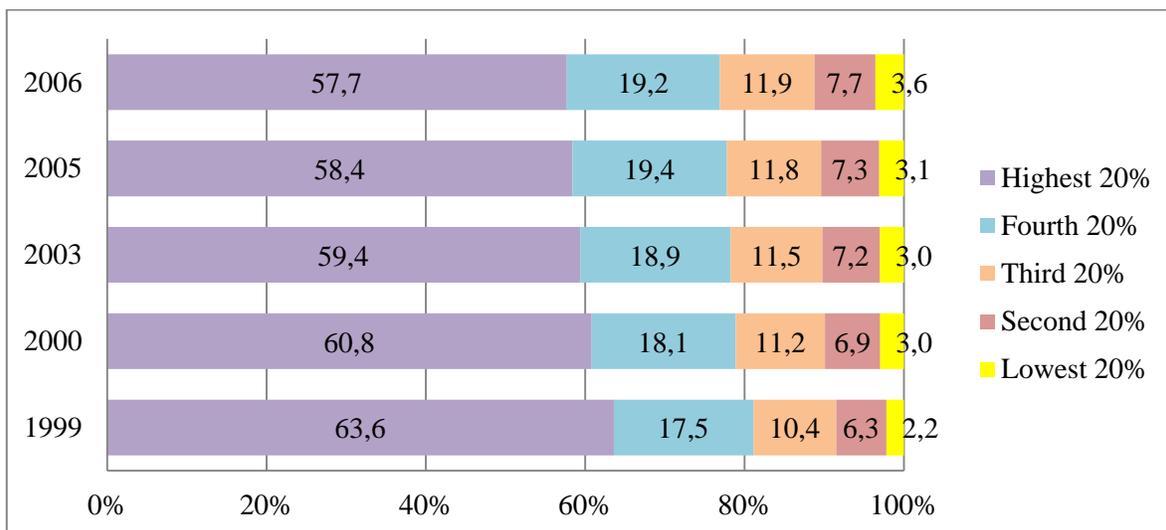
Graph. No. 11
GINI Index, 1999-2006



Source: World Bank, Development Indicators

*Measure of income inequality within a country. In this sense, 0 implies perfect equality whereas 100 represent perfect inequality.

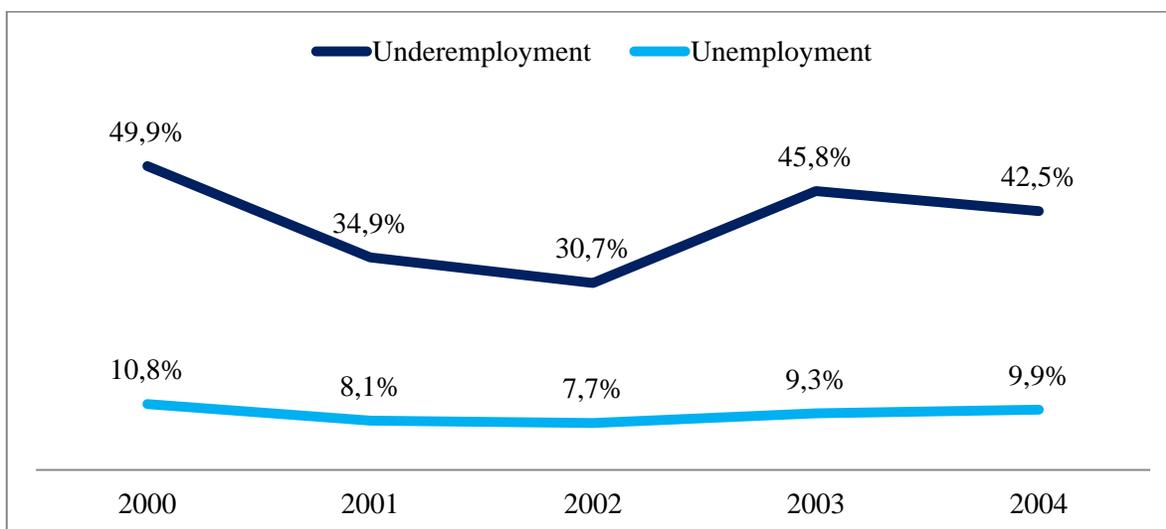
Graph. No. 12
Inequality trend, 1999-2006



Source: World Bank, Poverty & Equity.

Moreover (Sánchez, 2005) affirmed that this gradual recovery was the result of the establishment of the new economic system. Also, the labor sector experienced significant increases in employment. The Graph. No. 13 shows a modest recovery in the sector because the unemployment and underemployment decreased. Despite the downward trend in 2003, the underemployment reported 45.8% that accounted for almost half of the economically active population.

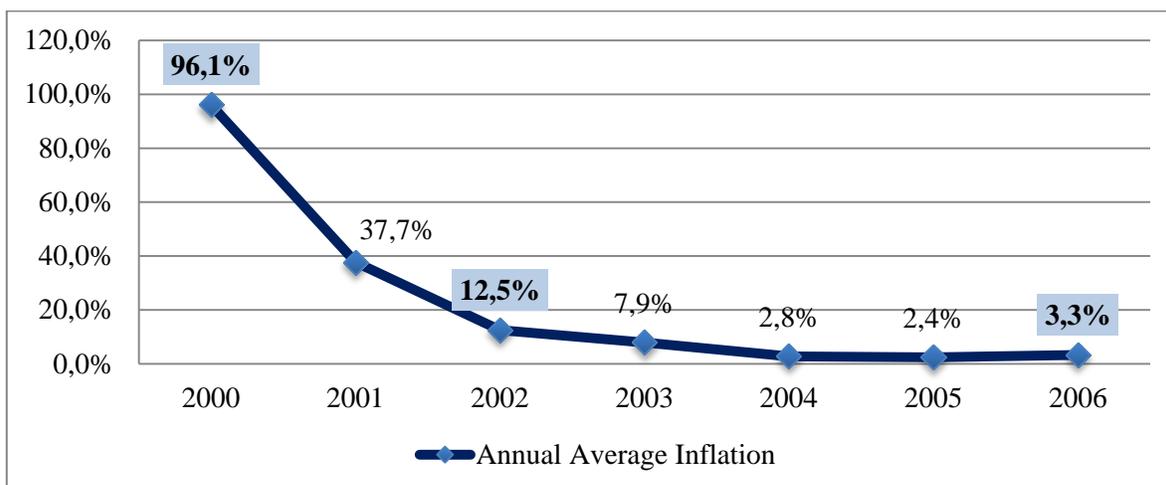
Graph. No. 13
Underemployment and Unemployment, 2000-2004
Percentages (%)



Source: Central Bank of Ecuador, Monthly statistical information

Further, since 2000, inflation converged towards international levels, but this process was slow and costly. In this respect, Ecuadorian Government obtained the expected results since the inflation decreased from 96.1% in 2000 to 12.5% in 2002 and finally to 3.3 % in 2006 (Acosta & Falconí, 2005). The next graph shows the downward trend of inflation.

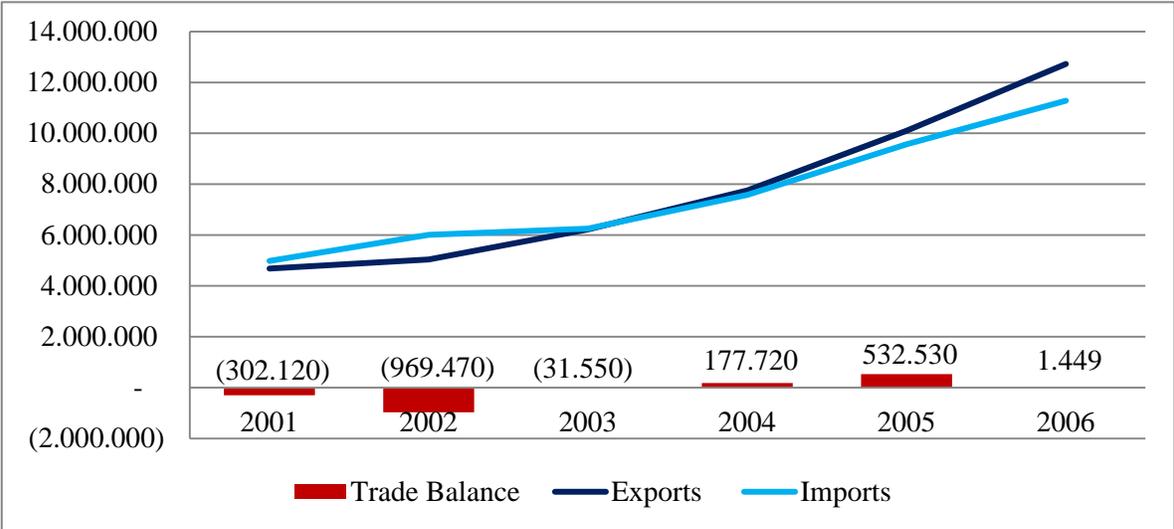
Graph. No. 14
Inflation: Rate of Change of Consumer Price Index, 2000-2006
Percentages (%)



Source: Acosta, 2012

Until 2003, the trade balance remained in deficit due to heavy reliance on imports of capital goods. But, since 2004, oil exports increased and Ecuadorian income rose due to high international oil prices. The Graph. No. 15 shows that the trade balance turned positive since 2004, but it rose slightly due to lack of competitiveness.

Graph. No. 15
Trade Balance, 2001-2006
Millions of dollars



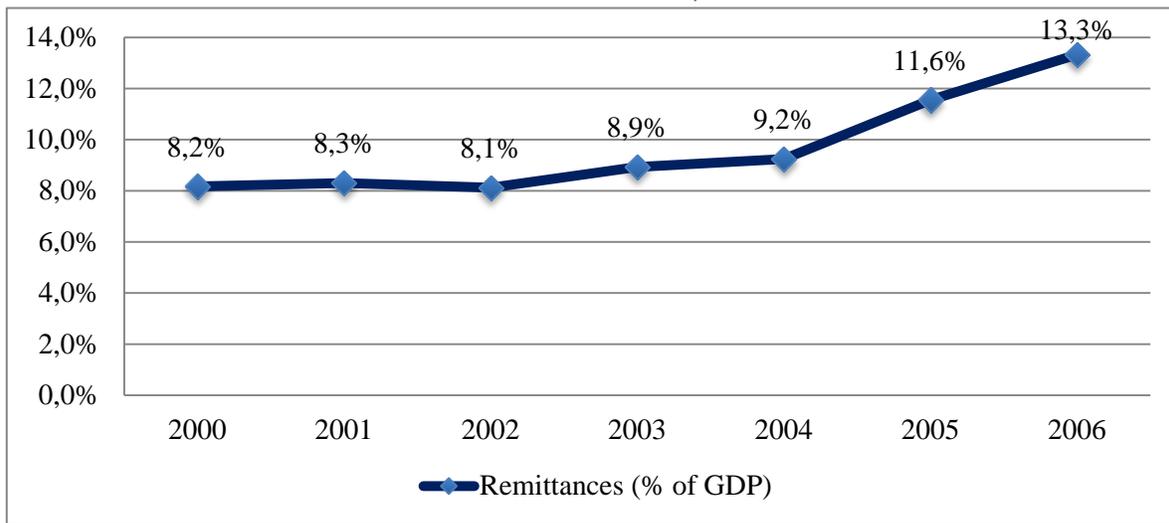
Source: Central Bank of Ecuador, Monthly Statistical Information.

In terms of tax revenues, the figures increased significantly owing to improved tax collection. But tax evasion remained high because a widespread custom called ‘native cunning’. This term refers to the lack of respect for rules and regulations, and also indifference to the common good in a context of individual interest.

Despite the inequity of government expenditure¹⁵, poverty gradually declined due to remittances sent by migrants. In this regard, remittances were an important resource for Ecuadorian economy. The Graph No. 16 presents an increasing trend, so the remittances/GDP increased from 8.2% in 2000 up to 13.3% in 2006. (BCE, 2005).

¹⁵ Most of government spending was directed to pay external debt that decreased from 97% of GDP in 2000 to 32% in 2006.

Graph. No. 16
Remittances as % of GDP, 2000-2006



Source: INEC, 2006.

Despite the recovery process, there were no substantial changes owing to 'dollarization'. The State was too weak to solve the crisis due to political instability. The most benefited sectors were powerful groups who had knowledge of 'dollarization' before its establishment. They profited enormously by acquiring obligations in national currency since they changed the money to dollars days before the event. Thus, political instability, corruption and impunity remained in the country during those years (Dávalos, 2004).

➤ **A Closer Look to the Core Concepts**

The second period began with a new window of opportunity that emerged as a result of the return to democracy. Although, this return did not emerge for the right reasons, still it was considered a big chance. This 'window of opportunity' changed the power structure and also contributed to the rise of a new belief in participatory democracy, because citizens did not know that military power was still controlling the power. The business elites and military groups took advantage of this window of opportunity, since they chose democracy as the only way to preserve their power. It brought new institutions and policies in the country based on neoliberalism.

The return of democracy was shaped by the implementation of 1979 Constitution under the leadership of Jaime Roldós. It promoted civil liberties, for instance it eliminated the literacy as a requirement to vote. Thus, indigenous participation increased in democratic processes.

It could have been a significant shift towards legitimate democracy, but the subsequent governments did not support the promotion of social rights. Rather, Hurtado used policies that favored to private sector and then Febres Cordero modified those policies to benefit the business sector (Guzmán, 1996).

Besides, Ecuador did not meet the requirement of social homogeneity, which was necessary for the establishment of legitimate democracy. Indigenous organizations were deeply divided by regional, economic, and social problems. And, there were no inclusive organizations because of the lack of policy objectives in favor of society.

The racism was institutionalized in Ecuador because the roles of the mestizos could not be performed by indigenous or black people, in spite of their rights established in the new Constitution of 1998, another formal institution which failed to enhance the living conditions of citizens. The belief of participatory democracy was weakened over time since the citizens suffered the consequences of political instability, international crises and economic imbalance. These facts contributed to the elimination of the belief.

Concerning, the structural reforms based on the 'Washington Consensus' model, these did not generate the expected results. As Alston noted in one of his conferences, the transplanted of successful models is not the solution for the national problems. These models do not work because the changes must be generated within countries (Ayala S. , 2014).

At the end of the 90s a new belief arose as a consequence of the financial crisis, this was the belief in economic terrorism. Consequently, people lived in an environment of uncertainty and fear. Also, the corruption became a widespread custom for Ecuadorian society, thus citizens lost confidence in the political system and society in general.

Accordingly, a new window of opportunity emerged as a direct result of the 1999 crisis. This was the right time to take advantage of the situation and thus solve the problems in the country. But the unstable governments wasted this window of opportunity, perhaps for fear of failure or the desire for power and personal enrichment. Again, they did not consider fundamental values and principles of society. In addition, the 'native cunning' as

widespread custom was adopted by political elites to enlarge their personal wealth; they knew that the corruption cases were not sanctioned by the law.

This period was characterized by corrupt governments; therefore citizens exercised their power to overthrow them. Thus, the old belief in economic terrorism was associated with a new belief, which was the belief in popular power. In this context, people realized that no one should abuse of the democratic power granted by the citizens.

The extractive economy, the survival of certain segregationist social hierarchies, the state's inability to enforce the rule of law and the emergence of various forms of populism, restricted the possibilities to achieve progress in Ecuador.

Lastly, the bad outcomes were part of bad customs, such as native cunning, dishonesty, corruption, tax evasion and mistrust. Besides, chronic political instability with unequal opportunities hampered Ecuadorian development. Again, the governments failed in the attempt to overcome the national problems, apparently an endless story.

5.3. Rafael Correa Seizes the Window of Opportunity, 2007-2014

After several years of institutional instability and bad governments, a new leader appears on the political scene. Thus, Rafael Correa seized a window of opportunity in order to embark the country into a new path towards a more open economic and political society.

As (Alston et al., 2013) noted, the window of opportunity emerges when the economic and political outcomes differ greatly from those expected by the people who make the rules. In this respect, in the post-dollarization period (2000-2006), Ecuador went through a recover phase after the 1999 crisis. The economic results showed a slight improvement in the country. However, the political outcomes were disastrous, democracy was weakened by constant abuse of power and leadership was absent. Thus, the fatality of political results provoked a crisis of political representation. The big institutional failures showed that representation of masses was almost impossible.

The neoliberal model did not bring the expected results. As an illustration: high levels of inequality and poverty, greater concentration of wealth in minorities and rapid deterioration of labor and living conditions (Correa, 2014).

The crisis of representation was a window of opportunity. This crisis showed the inevitable consequences of bad decisions, lack of leadership, international crisis, national crisis and political instability of the second period (1980-2006). So, Correa took advantage of this opportunity, and he used his leadership power to change the trajectory of the country and break the Ecuadorian neoliberal past through the implementation of some institutional changes.

According to the conceptual framework, Correa was the person who made the difference. He exploited his leadership skills and academic knowledge at the right time, i.e. when the window of opportunity appeared. The window of opportunity changed the configuration of power and it also led to a transformation of customs and beliefs that are essential to build strong institutional bases. It is important to consider that beliefs become malleable during a window of opportunity (Alston et al., 2013). The transition to new beliefs and institutions promotes social welfare and hence national development.

➤ **The Emergence of the Window of Opportunity in 2006**

Rafael Correa entered the political scene as Minister of Finance under the government of Alfredo Palacio in 2005. He obtained political recognition due to its strong nationalist and anti-neoliberal ideology (Mantilla & Mejía, 2012)..

As noted before, the hard and complex historical process experienced by Ecuador explains the beginning of a new period since 2007. So, taking into account the interaction of the key concepts, this period includes the strong presence of a leader (Rafael Correa) who took advantage of the window of opportunity (crisis of political representation), also he molded customs and beliefs and he took appropriate decisions in order to locate Ecuador into a new trajectory through the implementation of institutional changes that will lead to sustainable development in the future.

It does not mean that Ecuador has overcome underdevelopment, but rather that this country is on the right path towards development through deepening of new institutions and the recent belief in inclusive social transformation, which will be explained later.

So, what means crisis of representation? it was the absence or weakness of presidential leadership since 1996, plus the weakening of political parties and the 'leaders' of the traditional political class. Essentially, the crisis originated in the unresponsiveness of presidents and political parties to handle the new circumstances and needs of Ecuadorian society. This fact was represented in the second period during the years (1996-2006) through continuous changes and presidential overthrows (Paz y Miño, 2012). Indeed, during 1996-2006, Ecuador had seven governments. There were a short dictatorship and three democratically elected presidents, but they were overthrown by large citizen mobilizations, considering the dominant belief in popular power, since individuals wanted to stop the corruptions and the constant abuses.

Consequently, a new election was called in 2006, in which Rafael Correa participated as strange because he did not belong to traditional political elites. Nevertheless, he won the presidential election with great public support. Thereby, in order to fulfill his election commitment of country's radical transformation, Correa and his work team established a new constitutional process through three important phases, 1) a referendum to authorize or deny the call for a Constituent Assembly, 2) the development of a new Constitution and 3) an amendment to the Constitution (Mantilla & Mejía, 2012)..

So, the referendum concerning the Constituent Assembly was intended to reform the State towards decentralization and improve weak institutions of the democratic system. Its main objective was to transform the regulatory and institutional framework in the country.

Furthermore, the second phase regarding the elaboration of the new Constitution was crucial to shape the new belief in inclusive social transformation, which is part of the institutional change in Ecuador. Also, during the process of strengthening this institution (Constitution 2008), another phase appeared in 2011 that refers to a referendum and popular consultation. This phase will be detailed later.

In this context, these phases help to better comprehend the presidential decisions/incentives, institutional changes, sustained leadership, transition of new customs and beliefs and lastly the current outcomes in contrast to the first and second period. This

information will be useful to understand the break with its past through the application of new post-neoliberal model.

Besides, these phases legitimize and strengthen democracy. This process began in the second period in 1979. But, democracy was established for the wrong reasons, mainly to protect the interests of elites and military groups. In this way, 'democracy' began to have a real sense, thus the State started to build the foundation for democracy 'by and for' the people.

➤ **The New Constitution (2008) and the Emergence of a New Belief**

In the second period, the 1998 Constitution was designed under a neoliberal scheme. It was recognized for its advances in dogmatic matters but criticized for its organic development and institutional design. The formal institutions were weakened over time, and beliefs and customs were focused on anti-progress. A year later in 1999, the belief in economic terrorism gripped the country; this was a chaotic moment in Ecuadorian history.

The ideologues of the 1998 Constitution mistakenly thought that the strengthening of presidentialism would solve the problem of governance and thus the crisis of representation. Nevertheless, they did not consider the central problem: lack of leadership and political bad decisions that drove to inevitable crises in relation to banks and institutions (Mantilla & Mejía, 2012).

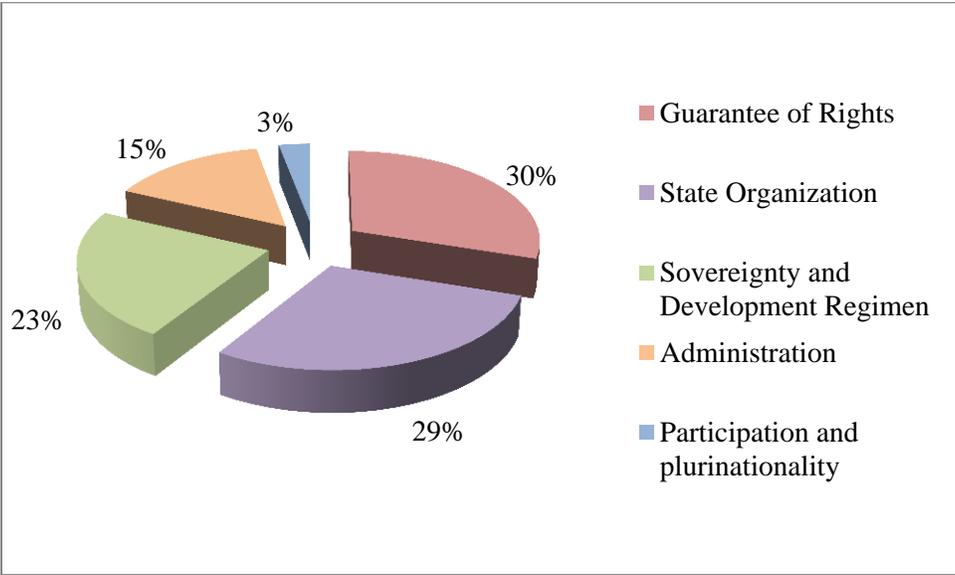
After that Correa seized the window of opportunity in 2006, he assumed the challenge of transforming a weak state. To achieve this goal, he formed alliances and coalitions in his favor. Consequently, the constitutional process was the result of the decisions of the president and his working team. In this context, the most essential programmatic change between the three phases was the Constitution of 2008 that established rules and regulations for society's welfare. Thus, many achievements in relation to formal institutions were generated. But much remains to be done in reference to informal institutions, collective action and cultural change.

As (Alston et al, 2013) noted, the most important belief belongs to the leader, in this case Rafael Correa started the belief in inclusive social transformation in early 2007 through his election promises. At the beginning of the period, this belief was not shared, only the president has this belief based on his future expectations.

Because electoral promises became reality, the belief in inclusive social transformation was spread throughout Ecuadorian society, which largely supported the president. It does not mean that there is no opposition or interest groups. Rather the president's belief was shared and strengthened by the citizens, who recognized that economic and social results matched the initial expectations. That was a major step in the new Ecuadorian trajectory.

Turning to the significance of the Constitution, its implementation was possible by the legislative activity that took place in the National Constituent Assembly in 2007. The Graph No.17 shows the percentage of statutory bodies approved by the judiciary. Most of them have been instrumental in the development of political model. In fact over 70% of the approved laws have had the function of guaranteeing the rights, structuring the government system and promoting development regime (Falconí & Muñoz, 2012).

Graph No. 17
103 Mandates and Laws Approved since 2007



Source: Falconí & Muñoz, 2012

Regarding, the third phase, the referendum of 2011 was centered on the transformation of justice. Its main objectives were to confront the monopolies and strengthen national security. It included a popular consultation, in which citizens positively answered the questions of national scope. Thus the individuals strengthened and supported the dominant belief in inclusive social transformation. It is important to note that the popular acceptance of Correa was supported for major changes and good results obtained as part of the constitutional process.

Indeed, the constitutional process restructures extant institutions in order to sustain the horizontal exercise of power. This implies the citizenization of the State mainly from community spaces such as collective forms of social organization. Therefore, democracy entered into a process of institutional strengthening and deepening. Further, as a result of the Constitutional process, labor rights, political security and social spending were strengthened, marking the start of the new path of institutional change in Ecuador (Mantilla & Mejía, 2012).

The Constitution for 'Good Living': this Constitution builds the institutional foundation for 'Good Living' that represents an alternative to conventional development in the case of Latin American countries (Acosta, 2012). In this regard, the 'Good Living' has been applied in the elaboration of planning programs, which tries to apply a set of policies and instruments to alleviate the condition of 'underdevelopment' (SENPLADES , 2010).

International organizations recognize the country's achievements in social, politic and economic terms. For instance, ECLAC highlighted achievements by the Ecuadorian government in reference to the reduction of inequality and poverty rates through a dynamic economic policy from the lower strata. Thus, the economy must achieve equality to grow, so governments should not focus only on growth (El Telégrafo, 2012). The next section will analyze social and economic transformations that support a democratic growth with greater justice.

➤ **The Economic and Social Transformation**

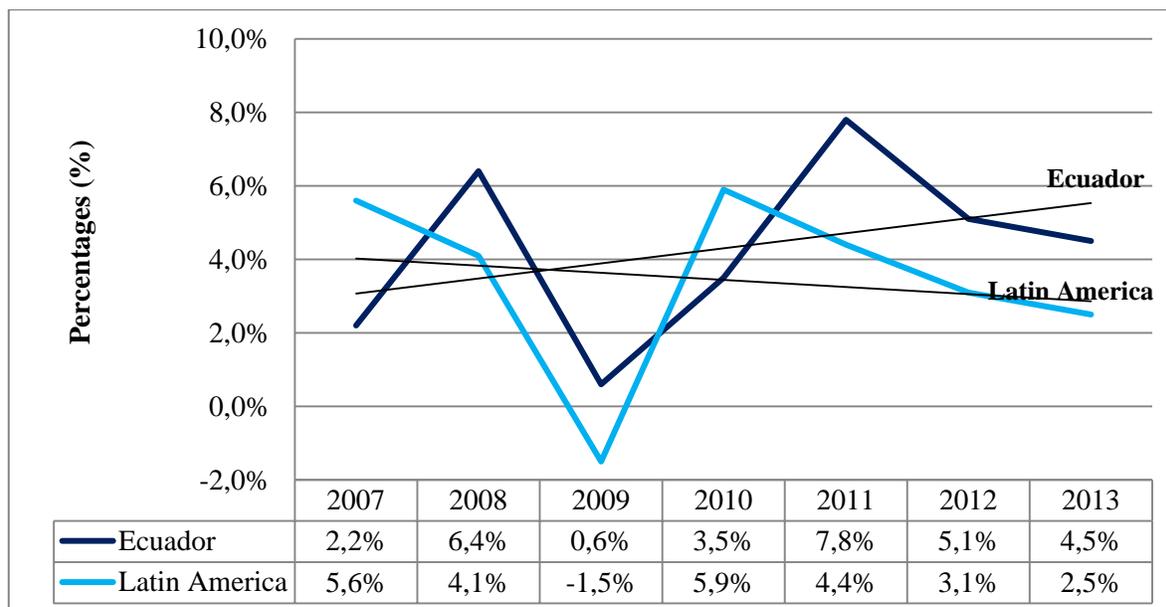
Correa and his working team replaced the enterprise model based on neoliberal ideology, with a new post-neoliberal model focused on a process of endogenous development. In this way, the Ecuadorian State regained its involvement in the economy while business groups and elites ceased to be the hegemonic sectors (Falconí & Muñoz, 2012).

Ecuador's economic progress is widely recognized through economic statistics and annual reports of international organizations, such as ECLAC and the UNDP. The economic and social results described below confirm the start of a new path towards a more open society. Within this context, the economy cannot be assessed only by the value of final goods and services produced in the country. In this case, the Ecuadorian government has considered strengthening distributional equality and equity as major factors for achieving 'Good living,' denoted in the 2008 Constitution.

The change of economic policies has promoted the concept of economic, social and solidary system, breaking with the neoliberal paradigm of the past that identified growth with development, and capital over labor. The results of economic policy are measured not only in terms of production and growth; rather it is mainly about employment generation, poverty alleviation and the decrease of inequalities (Sánchez, 2012).

Ecuador has grown steadily except in 2009 due to the effects of international crisis, but despite national vulnerability to external shocks, the country recovered from the drop and continued with a growing trend. The Graph No.18 shows that in 2009, Ecuador fell at 0.6%, nevertheless this country did not have a negative percentage compared to Latin America. In 2011 Ecuador reached its highest economic growth around 8%, this is a third place at the regional level after Panama (10.9%) and Argentina (8.9%) (ECLAC, 2011).

Graph. No. 18
GDP Growth Rate (%), 2007-2013

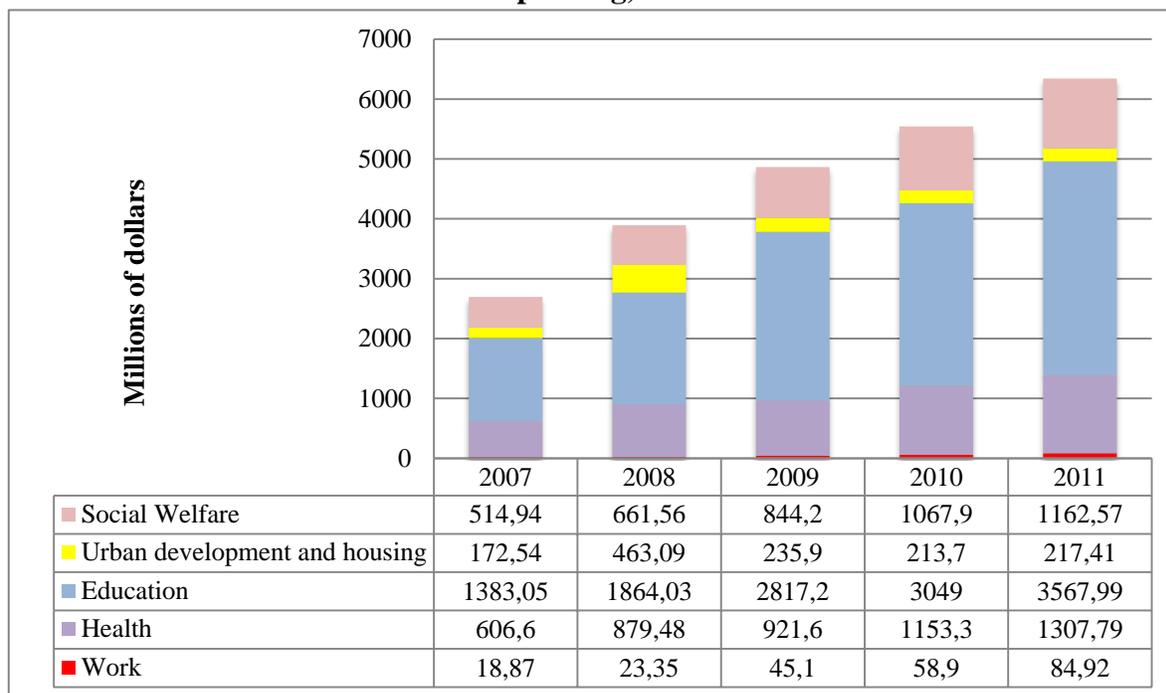


Source: ECLAC, Economic Indicators and Statistics.

As a crucial part of this economic growth, the government changed its priorities towards public investment. So, the state invested a higher percentage in the social sector, and less on service of external debt. Thereby, in 2011, 7% of the National Budget was used to pay external debt while in 2006 was 32%. In this context, Ecuador achieved one of the most successful debt renegotiations in Latin America (Pozo, 2012).

During the post-dollarization period, social spending as a percentage of GDP was about 4.5%, but since 2007 this percentage doubles and reaches 9.62%. The next graph shows that social spending, especially in education, health and social welfare has increased dramatically.

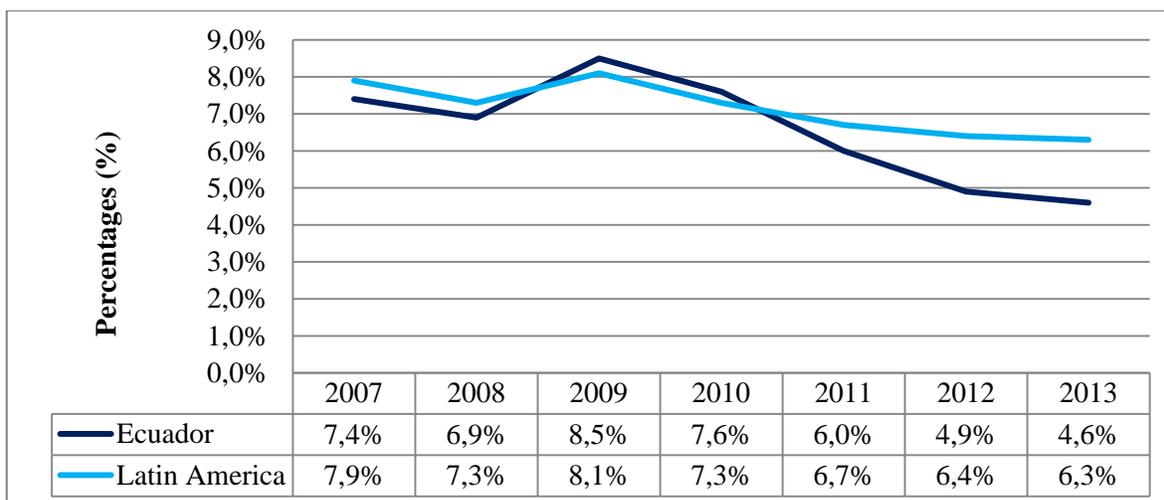
Graph. No. 19
Social Spending, 2007-2011



Source: Mayoral, 2012.

Concerning the topic of equity and abilities, institutional changes have promoted the reduction of unemployment, poverty and inequality. And it also increased coverage of social services (Mayoral, 2012). In more detail, in terms of unemployment, the Graph No.20 indicates that in 2013 Ecuador had the lowest rate of unemployment over the period (4.6%). Thus, unemployment has experienced a downward trend compared to Latin American average. However, the percentages for the years 2009 and 2010 correspond to the effects of international crisis, for that reason those percentages are higher.

Graph. No. 20
Unemployment Rate, 2007-2013

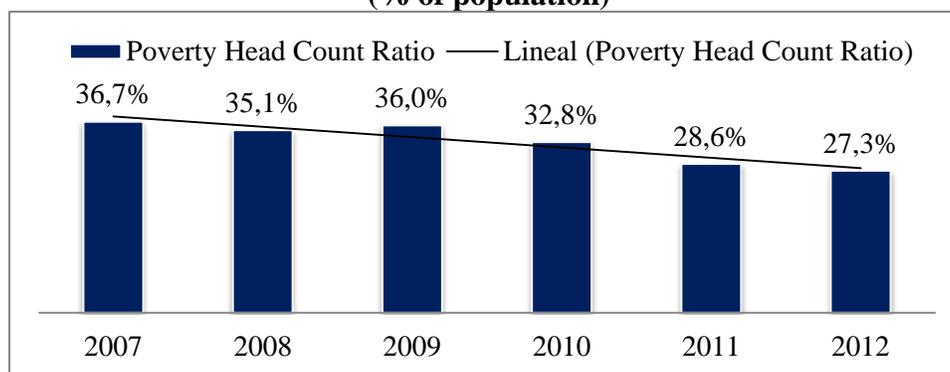


Source: ECLAC, Economic Indicators and Statistics.

Furthermore, in 2001-2006, the percentage of coverage of the basic food basket by the average family income did not reach 70%, in contrast in 2011; the current government covered 85% of that basket. This fact is important since it creates solutions for one of the most crucial needs in developing countries: a living wage (Falconí & Muñoz, 2012).

Besides, the reduction of poverty and inequality is one of the greatest achievements by the 2008 Constitution and State Planning. Accordingly, the Graphs Nos. 21 and 22, show their downward trend. Thus, the improvement of equity, equality and redistributive justice is undeniable.

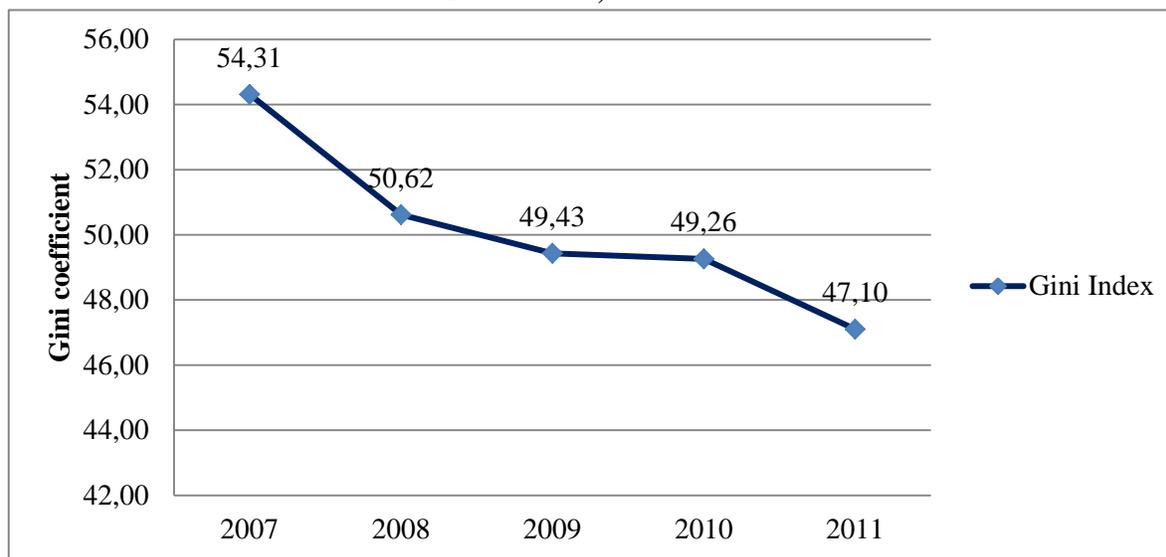
Graph. No. 21
Poverty Head Count Ratio at national Poverty Line*, 2007-2012
(% of population)



Source: World Bank, Poverty & Equity.

*This graph shows the evolution of poverty in national poverty lines of Ecuadorian case.

Graph. No. 22
GINI Index, 2007-2011



Source: World Bank, Poverty & Equity

In the process of spread and strengthened the belief in inclusive social transformation, the president and his work team through their choices on economic policy have achieved significant progress in the country. As an example, by means of conditional transfers, Ecuadorian government has covered to almost all persons in need. The overcoverage and undercoverage have been eliminated almost entirely.

Although Ecuador has achieved significant progress in the new path sustained by institutional changes, it is also true that there are still great challenges to deter deviation from the trajectory towards an open society. For instance, the inter-institutional action is still insufficient and some Ecuadorian customs have not been modified in accordance with the dominant belief in inclusive social transformation.

➤ **Spread of the Dominant Belief through a New Fiscal Policy**

The belief in inclusive social transformation was propagated from the president to society due to the strong results obtained from the constitutional process. Moreover, the social and economic transformation was the result of the change in economic policy in favor of an equitable society; so it provoked changes in the social behavior of Ecuadorians. The outcomes were consistent with national expectations. After a long time, the governmental leadership was able to eradicate most of the abuse of power and corruption of the elites.

In order to sustain and strengthen the belief in inclusive social transformation, fiscal policy plays a necessary and crucial role. In this respect, the 2008 Constitution raises an equitable and redistributive economy. So, the government has focused on improving the tax system, apart from the changes in economic policy. The creation of a tax system that redistributes wealth is an essential element in democracy to break with the historical trend (Viteri, 2012).

Tax evasion was one of the common customs of the citizens in the second period since they knew the law weakness. But, this custom was modified. Since 2007, due to institutional changes and strengthening the law, most people complied with their tax obligations to avoid penalties and contribute to progress. So the change of custom was generated by the belief in inclusive social transformation.

In short, fiscal policy plays an important role in achieving the functions that the Constitution granted the State, because it has the ability to change the incentives of citizens. Thus, the State has shown that it properly handled these issues with direct regulation through law enforcement and several economic instruments.

➤ **A Closer Look to the Core Concepts**

The second period was characterized by two crucial beliefs; the first belief arose from the 1999 crisis, in which Ecuadorians suffered the negative consequences of political, social and economic instability. Belief in economic terrorism forced people to make tough decisions in search of better living conditions. For this reason, many Ecuadorians migrated to several countries, including Spain and the U.S.

People lost confidence in the government and the entire political system. The belief in economic terrorism weakened but not disappeared in this sense dollarization sustained the presence of this belief. Although economic indicators showed a modest improvement; political instability led to a situation of continuous anxiety in the country.

Democracy played a minimal role, since people chose their leaders but they did not respond to national interests. Moreover, elites sought to strengthen its power at the expense of country's stability. Consequently, due to popular discontent with political outcomes, the belief in people power emerged as a solution to stop the corruption and abuse of power. In

the post-dollarization period; the people overthrew three governments in a row, thus it started a crisis of political representation in the country.

The crisis of political representation reflected a new window of opportunity that emerged in the new electoral process in 2006. Correa took advantage of this window of opportunity and won the election with a large percentage above his competitor Alvaro Noboa, who represented the country's wealthiest sectors. People opted for a new figure which proposed a total transformation of the country.

As described above, the beliefs during the window of opportunity are malleable but the beliefs must go through a long process of adaptation, strengthening and deepening. Thus, in 2007 Correa began a new belief in inclusive social transformation based on his expectations as leader of the country. Nevertheless, in the beginning of this period this belief was not shared by society since this process requires citizen's support and also takes time.

This period recovered the belief in participatory democracy, in which Correa's leadership was instrumental to the establishment of democracy 'by and for' the people, since the State recovered the lost role in the neoliberal years. So he and his working team promoted the creation of a constitutional process in three phases, 1) the referendum for the establishment of the Constituent Assembly, 2) The 2008 Constitution; and 3) the amendment of the Constitution. Its main objective was the construction of a more fair and equitable society.

Accordingly, in order to build the basis for distributive equity and equality the Government decided to change most of the economic and fiscal policy. The economic and social transformations show that the results were consistent with initial expectations. Therefore belief in inclusive social transformation was expanded to most of society and people started to support the government system and to the President.

The popular acceptance of President has grown dramatically. In this regard in 2013, Correa was re-elected for a new government term. Certainly the reasons for his re-election were based on his strong leadership, institutional changes, weakness of the opposition, discrediting of national elites and economic and political stability (Mejía, 2012).

The new path taken by Ecuador includes several institutional changes arising from the Ecuadorian constitutional process. Furthermore, the dominant belief of inclusive social transformation has played an important role to strengthen democracy and the institutionalism in the country. Thus, it is the beginning of a new era focused on a strong dominant belief. Despite the major transformation and institutional changes there are still many things to be done at least in reference to informal institutions.

The dominant belief in inclusive social transformation has replaced the belief in economic terrorism, but the 'belief in popular power' was associated with the dominant belief. In this sense the majority of the population support to Correa's leadership because these people trust that these changes are not transitory. They hope that this new path will be continuous. However it should be noted that it takes a long period of time (not just 7 years) to confirm that these changes are not accidental interaction of key concepts. But it is possible that these changes represent the beginning of sustainable development for Ecuador.

Finally, in the appendix, the Table No.6 shows a summary of the three periods with their respective beliefs, institutions and outcomes.

6. Conclusions

Since mid-1950, when the 'development' emerged strongly as the goal for developing countries, Ecuador has tried to achieve this path in different ways. For this purpose, governments have imposed certain strategies including several development models, planning programs, policies, etc.

The path towards an open society has struggled due to high international dependence particular with the U.S., high levels of external debt, decline of agricultural booms, drop in oil prices, natural disasters, etc. Besides, certain beliefs and customs have hindered Ecuadorian progress, for instance: corruption, abuse of power, native cunning, and the beliefs in permanent social status and economic terrorism.

In this sense, Ecuador broke away from its past, since this country changed its trajectory towards a more equal and inclusive society.

According to (Alston et al., 2013) leadership is essential to understand how certain individuals at certain times in the history of a country make difference through their actions. This is just what happened in Ecuador when Rafael Correa seized the window of opportunity in 2006 that was the 'crisis of political representation' in order to shape social beliefs and create a deep structure for good outcomes. Thus, since 2007, Correa and his working team through the creation of a solid constitutional process have changed the trajectory of the country for better. So, it is important to stress that leadership was instrumental and necessary in this process.

In this period (2007-2014) things have changed positively in Ecuador, which is confirmed by the economic and social outcomes. Economic growth and social spending had an upward trend, while poverty rates and inequality have declined significantly. Thus these results support the existence of a more open society. Furthermore, unemployment has declined steadily, which fosters one of the goals of state planning: the living wage.

Regarding the hypothesis: the constitutional process has been quite robust, mainly the second phase: 2008 Constitution that has shaped institutional changes in the country. The Constitution through planning of 'Good Living', economic policy, fiscal policy and a myriad of laws and regulations has produced not only good economic and political outcomes, but rather greater social stability. Accordingly, the society has entered into a process of distributive equity and equality. In fact, this institutional change has generated the expected results according the expectations of the president and citizens.

The Constitutional process was not an improvised rule, the study of their impact on institutional changes and economic and political performance has shown that Ecuador is in a new process towards a better society. These changes have been recognized by international institutions such as ECLAC and UNDP in its annual reports.

In this respect, given the facts and circumstances; one can reasonable infer that Ecuador is a different country compared with its past. Thereby, this thesis provided strong connection between the circumstantial evidence and the hypothesis that is reflected in the constitutional process and its major changes regarding the increase in growth rate and social spending, and the decrease in unemployment, poverty and inequality. Moreover, the adoption of new

beliefs in society (in accordance with social welfare and national progress) promoted living conditions in the country.

According to the framework developed by (Alston et al., 2013) the strong circumstantial evidence provides relevance to the case study. Also, Alston said that the hypothesis should not be rejected when there is a strong link between the evidence and the hypothesis. Consequently, due to the nature of analytic narratives, the study of the Ecuadorian case found strong support for the start of a new trajectory since 2007. In this case the hypothesis should not be rejected since the constitutional process was the trigger of institutional change towards a more open society.

The analysis of interaction of the concepts has been fundamental to this Master thesis, regarding the explanation of the emergence of a new society. Thus: the leader (Rafael Correa) through the window of opportunity (crisis of political representation) has changed Ecuadorian society for better. His initial belief in inclusive social transformation was spread in society by institutional changes (constitutional process) and good economic and political outcomes. As a consequence, the belief in popular power has changed, i.e. this belief no longer overthrows governments, instead this belief supports governmental decisions. For this reason, Correa was re-elected for a new term, which shows that the facts are not acts of pure chance.

The new expectations of citizens in this second term of the government exceed the current results. In other words, people have regained confidence in the executive and they expect new and better changes. Its expectations have grown in order to strengthen the belief in inclusive social transformation. This is a difficult challenge, but if Correa and his working team maintain their incentives aligned with the dominant belief, it is more likely that in the future, citizens' expectations will again coincide with the outcomes.

Unlike the described-above facts, this research has a clear prediction based on the amount of circumstantial evidence. That is, that in the future Ecuador will strengthen its process of institutional change and also it will deepen the belief in inclusive social transformation, as long as there is a strong presence of a leader that supports the changes made during this period. Unfortunately, the analysis time of separation from the past (2007-2014), is too

short to state with certainty that Ecuador will not return to instability in economic or political terms.

Similarly to (Alston et al., 2013) this study has no inclination towards certain president or political party. The findings were just a result of the strong link between the evidence and the hypothesis.

Finally, it is true that Ecuador has initiated a process of social and economic transformation, but the process of 'changing customs' is a fundamental challenge to undertake. It is impossible to deny that there is currently a lag between changes in formal institutions and the immobility of informal institutions. Because even though some customs have been eradicated , other customs still respond to the pattern established in the neoliberal model, such as : social polarization, individualism and loss of values. Therefore, to achieve the prediction described above, it would be necessary to reduce the gap between formal and informal institutions.

7. References

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8. Appendix

Table No. 6
Ecuadorian Development since 1950*

PERIOD	1950-1979	1980-2006	2007-2014
BELIEF	Personal and National Development	Economic Terrorism / Popular power	Inclusive Social Transformation
INSTITUTIONS	Economic: limited economic prosperity, public planning through the Planning Board. It also includes Import Substitution and Industrialization. Agrarian Reform that eliminated 'huasipungo' (institution of precarious work)	Economic: neoliberal policies, deregulation of the financial system; enterprise development model, Agrarian Development Law.	Economic: public planning with the new ideology of 'Good Living', new economic and fiscal policy.
	Political: Constitution of 1979 that comprises the institutionalization of political parties and promotion of national rights	Political: return of democracy (meta-institutions), 1998 Constitution under neoliberal ideology	Political: Constitutional process: Constituent Assembly, 2008 Constitution, the constitutional amendment of 2011.
OUTCOMES	Economic: limited growth, more 'extractivism', high dependence on external relations, economic instability.	Economic: financial crisis, high inflation, economic slowdown.	Economic: growth with equity, reduction of poverty and inequality and drop of unemployment. Also, an increase of social spending.
	Political: the largest period of dictatorships, political instability and weak democracy	Political: price stabilization, weak democracy, huge political instability due to crisis of representation.	Political: social inclusion through the implementation of good policies. Strong presence and leadership of certain political parties.

* This table was made through the results obtained in Analytical Narratives. It is important to said that the design of it was based on the conceptual framework developed by (Alston et al., 2013)