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Local Initiatives and IMF Policies in Quito, Ecuador

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Abstract¹

If we are to define development as an increase in the freedoms people enjoy, then we may move beyond structural adjustments and foreign investment as means to create wealth in Ecuador and Latin America. Although not conclusively documented one way or the other [13], microlending is a promising path towards development from this perspective. At the very least, microlending offers hope to a segment of the population that would otherwise be disenfranchised. In Quito, Ecuador, microlending programs are creating wealth and expanding freedoms in a manner consistent with capitalism, while a good deal of IMF policies extract wealth from the poor through a central authority far-removed from the general population.

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First and foremost, I thank my parents for supporting all of my travels. I would also like to thank Paulina Díaz and all of her family, Padre Carollo, Padre Graziano, Padre Pablo, Marco, Estrella, and the rest of the hard working people at the Tierra Nueva Foundation and the MCCH for sharing their time, resources, and world with me. I would also like to thank Dr. Chuck Dietzen, Scott Keller, Darrell Wheeler, Nick Hillman, and the rest of the volunteers of the Timmy Foundation. I would like to thank the Indiana University Honors College, and in particular Edward Hutton, for their financial support of my travels. And I thank my advisor Dr. Roy Gardner, whose guidance has been invaluable to me. Any opinions or mistakes put forward in this paper are my own.

I. Creating Wealth

Among the long litany of chance events that led to Francisco Pizarro's lucky conquest of the Incan Empire, a timely civil war had enabled Pizarro to capture the empire's theocrat Atahualpa. Since it was completely centralized, Atahualpa's capture paralyzed the great empire, which simply could not function without him. The Spaniards, who were once trembling with fear at the sight of Atahualpa's seemingly infinite troops and wealth [5, p. 38], were thus able to conquer the vast Andean region with only 180 men while the empire laid motionless [6, p.11].

Again today the vast resources and potential of the Andean region lay in a state of paralysis. Yet now the people are disenfranchised and feel powerless not for lack of a central theocrat, but rather for lack of economic opportunity. This lack of economic opportunity has caused discontent with the current form of capitalism in Latin America to grow out of control. Among many contemporary examples, this discontent is manifest in the political violence that is making Bolivia nearly ungovernable [23], and the policies of Venezuelan president Hugo Chavez that are crushing growth. And yet these particular examples may only represent the tip of an iceberg impeding economic growth in Latin America.

Considering the root causes of such political violence and growth-killing policies, it is astounding that the rich of Latin America (and the rest of the world) do not recognize their own potential benefit from providing basic services to the poor. This paper will discuss International Monetary Fund (IMF) policies that have neglected the poor, and the

path towards development offered by microfinance. Just as defenders of IMF programs point out [8], the poor of Ecuador would surely be worse off had their government not focused on growth. Yet an over-emphasis on this narrow definition of development (while itself not even having proven successful in Latin America [21]) has caused a sort of economic myopia that has pushed policy to the extreme. Structural adjustment agreements are a principle example of such policy. These agreements, which give absolute priority to paying down debt, have led to the elimination of vital government services that will ultimately kill growth.

As a path towards development, economic empowerment lies just beyond the current myopic vision. If our definition of development is to expand choice and opportunity, then the crux of development is enabling people to create wealth. This is where the great Peruvian economist Hernando de Soto argues that, “importing McDonald's and Blockbuster franchises, is not enough to create wealth. What is needed is capital, and this requires a complex and mighty system of legal property that we have all taken for granted.” [2, p. 66]

But is an improved legal system really all that is needed to turn capital into wealth? Clearly the official legal system is essential to the economic enfranchisement of the poor. Just as noted by de Soto, the official legal system in Ecuador does not meet the needs of the poor entrepreneurial class, and thus has caused much of the economy to become extralegal. Yet while de Soto repeatedly emphasizes that the poor cannot create wealth without a realistic formal legal system, without a banking network catering to the needs

of the poor, all of the laws and statutes in the world will not obtain a loan for a poor entrepreneur to promote her business. Thus I believe that de Soto has left out the other half of the system that turns capital into wealth: banks. Considering the importance of banks in creating wealth, micro-enterprise holds the greatest long-term promise for the development of Ecuador, a country whose annual per capita GNP is \$1,210 [26], and where 88% of country-side residents live in poverty [27].

II. The MCCH

A. Basic Information.

The South of Quito, also known as Quito Sur, is separated from the North of Quito by a large statue of the Virgin Mary atop a hill called “El Panecillo.” When I arrived in Quito, I remember wondering what all of the “Third World” fuss was about. Then I passed by El Panecillo and entered Quito Sur. In Quito Sur, the average household income is between \$80 and \$100 per month (\$960- \$1,200 per year), 40% are without basic services (potable water, sanitation, and/or electricity), and the number of hospital beds per 1,000 inhabitants is 0.268 (compared with the international standard of 4.5). [34]

Through the Timmy Foundation² and the Tierra Nueva Foundation³, I was able to work with a microfinance bank in Quito Sur during the summer of 2002. Founded by Father José Carollo in 1970, the Tierra Nueva Foundation seeks to “provide affordable health care and education services to individuals in need” [37]. Working next door to complement these services of the Tierra Nueva Foundation is the Maquita Cushunchic

² Based in Indianapolis, IN, USA.

³ Based in Quito, Ecuador. In English, the “Tierra Nueva” Foundation roughly translates into the “New World” Foundation.

Commercializando como Hermanos⁴ (MCCH), a trade group of the poor supported by the Catholic Church. Among other services provided, the MCCH has helped to organize peasants so that they are paid a fair price for their crops. The primary mission of the MCCH's co-operative bank, started by a group of clergy in 1998, is to help micro entrepreneurs in Quito Sur.

The co-operative bank today has more than 10,000 clients who come from all trades and all areas of Quito, with the vast majority coming from Quito Sur. The fact that women comprise 65% of these clients affirms the role that women are to have in Ecuador's development. For their work, bankers at the MCCH earn a salary between \$260 and \$1000 a month, whereas workers at a large bank in Ecuador earn between \$300 and \$10,000 a month. Although there do exist some co-operatives strictly for military personnel or women, Quito has no banks similar to the MCCH. A primary feature that distinguishes the MCCH from other banks is that the MCCH gives loans at interest rates far better than larger banks. Another distinguishing feature is that the MCCH gives loans to customers with no hope of obtaining a loan in a larger bank because of their collateral (or lack thereof), their income, or the intended destination of their loan. And while the bank does make a profit from its work, it also receives loans from foreign institutions at a preferential rate.

⁴ This roughly translates into "Our Hands Commercializing as Brothers."

My job at the MCCH was to enter records into a computer database. In return, I was given the privilege of accompanying a banker named Marco⁵ while he made inspection visits. Visiting the homes of loan applicants in order to assess their collateral, Marco and I would make a handful of inspections in an afternoon. These inspections highlight that just as there is no royal way to Geometry, there is no easy path to development. Micro-finance is a promising path to development, but it will not alleviate the need for hard work by dedicated individuals.

The main reason for the necessity of the MCCH's inspections is the high accessibility of the MCCH's loans. In order to obtain a loan, one need only present one's cédula (a personal identification card; to be discussed further in Section 4.2), a certificate of employment (or a certification of income in the case that the applicant has her own business), and a guarantee who can pay for the applicant should the applicant not be able to pay for some reason. Whereas many residents of Quito Sur operate their businesses outside of the official legal system, it is often very difficult to verify their information. The inspections offer a way around this problem while giving the bank another method of screening applicants.

Loans from the MCCH improve businesses, pay for health and educational expenses, pay off past debts, and help with other general living costs such as home maintenance. These loans range between \$100 and \$3,000, and go a long way in augmenting the income of

⁵ Along with the rest of the staff at the MCCH, Marco is professional, educated, and hard working. He received me with open arms, answered all of my pestering questions, and pointed out a good deal that I would otherwise have missed along the way. I have come to believe that working closely with a local banker such as Marco is the best way to familiarize oneself with the local economy of a region.

residents of Quito Sur. Yet even assuming that the bank does not aid in increasing income, as a result of the bank's activities supporting a free market economy, the bank's members enjoy all of the positive externalities in terms of social opportunity that result from the market mechanism. This is because the recipient is able to choose to what end the loan is directed. This choice represents a positive externality of value independent of the overall income effect of the bank. This virtue of the market causes an expansion in freedoms that enables our definition of development to be satisfied even in the absence of growth, as clearly explicated by Amartya Sen in [17, p. 112-116].

B. The First Encounter

The first inspection on which I accompanied Marco was in the southern extreme of Quito Sur. There is not much foreign investment in this part of town. When the prospective client insisted on paying our 10-cent bus fares, I began to feel bad for coming along, as the fares were evidently big-ticket items for him. After our bus ride, he proceeded to buy a two-liter of Coca-Cola before taking us along the long dirt road leading to his home. Livestock such as chickens and hogs roamed freely, small streams and dirt paths abounded, and from time to time one would catch the waft of a small fire. The corner of one's eye could not escape from the litter.

After spending an extended minute tidying his home, the man invited us inside. The man's home, made of cinder block, was about 15 feet by 20 feet. Cardboard lined the walls, and spare metal provided the roof. He lived with his wife and three children. His wife was not present since she was at work, which for he and his wife consisted of selling

clothing on the street. He and his wife had outstanding debt for their appliances (a stove, a refrigerator, and an old television), but were able to pay for these from their current earnings. The man wanted a \$500 loan in order to buy more apparel to further his business. Along with raising his income, he hoped that the loan would one day allow him to be able to rent a small shop instead of always doing business on the street.

This man's situation highlights the need for a banking network that caters to the poor.

When Marco asked him if his street vending was legal, he immediately produced documents showing that he was operating legally. In fact, he also receives special assistance from the government because he has such terrible vision. He has absolutely no complaints in terms of the protection of his personal property rights. But this alone does not ensure that his business will be able to thrive. For without a loan from a bank, his personal property rights are of little use.

C. Subsequent Visits

An important observation is that Marco was constantly being stopped or saluted by passers-by while we were on the way to our next inspection. I felt as though I was walking alongside a local celebrity for all of the attention we received. While Marco does have a good personality, this alone does not explain his popularity. He is well known in the community because he offers opportunity.

During the inspections that followed, Marco and I visited enough homes for me to surmise that the economy in Quito Sur revolves around small enterprise. For example, at

the end of one interview, while I thought that we had gotten up to leave, we had in fact gotten up to go and look at the lady's 35 chickens. I had incorrectly assumed that the lady raised her chickens away from her home. This surprise, along with the many other house visits we took, taught me that business owners are financially quite independent in Quito Sur. We made inspections for loans intended for sewing machines, chickens, rubber and leather for shoes, car repairs, furniture for a restaurant, toys, and perfumes, all in Quito Sur.

III. Extracting Wealth: The IMF

A. Education

Socrates believed that man sins for lack of knowledge, and that therefore the root of all evil is ignorance [15]. If only for the inherent value of education, this belief lays a strong philosophical foundation for the promotion of education. But is there any economic value in emphasizing education in Ecuador? The disappointing worldwide empirical correlation between education and growth during the past four decades [3] might indicate that education should be a low priority for Ecuador. Even so, nearly everyone in Ecuador still considers education to be a top priority, regardless of their social class.

After I would finish with my work around eleven-o'clock, Marco and I would go for inspections until one-o'clock, at which time we would return for lunch. As we continued making inspections, I began to notice subtleties that had initially escaped my grasp. For one thing, I noticed that Marco and I were often fighting our way through groups of uniformed children. I knew that my parents had returned home for lunch in the middle of

their school day, so I had assumed that these children were doing the same. I asked Marco at what time the children returned to school, and until what time did they then stay at school. He looked at me a bit confused, and informed me that these children weren't going back to school. They were home for good.

Marco then gave me a brief overview of the Ecuadorian education system. While some official reports might describe education in Ecuador differently, this is in fact the reality of education in Ecuador as it faces the poor. Years ago (at least while Marco was in school) students would come home sometime between noon and one-o'clock for lunch, after which they would return to school until six o'clock. Today, as IMF agreements have crunched Ecuador's education budget, these children simply do not return to school after lunch. Marco had noted to me that the economy always seems to pick up after a success of the national soccer team. Now there is simply an incredible abundance of time for Ecuadorian children to perfect their soccer game: maybe that is the IMF's plan to jump-start Ecuador's economy.

This is not to mention that public schools are not so public in Ecuador (as is the case in many developing countries). To begin with, on top of the costs of books and supplies, there is a fee for tuition. This fee immediately eliminates the poorest of the poor from the entire process, along with causing a significant percentage of children to sporadically miss school [36]. If a student does have the economic resources to attend school, then the student is able to choose to attend the public school of her choice. But it turns out that even this is not such a simple process. Students must register in their school of choice for

the upcoming year, but the low education budget ensures that there are never enough spots for all of the children. As a result, sheer chance forces many economically privileged children to sit out a year or two.

When 120,000 teachers held a strike in August because they were awaiting \$100 million of their July salaries, the Minister of the Economy said their salaries were delayed because the government budget simply did not include the salaries [22]. This is a prime example of how the education budget has withered in the wake of structural adjustments.

In 2000, over half of the government budget went to servicing the debt, while education spending was reduced by \$37 million [36]. Although left-wing president Lucio Gutiérrez's budget for 2004 will only divert one-third of the government's revenue to servicing the debt, it will still only put one quarter of its revenue towards social spending [29].

Ecuadorian citizens, both the rich and the poor, know that education is the path to economic empowerment. As they perceive it, the hopes of taxi drivers and street vendors are all contingent on the education of their children. Thus education is viewed as a means to self-improvement, so people are responding to the right incentives for education spending to contribute to growth. Could it be that structural adjustments are made in order to ensure the repayment of old debts without ensuring economic growth for the citizens of Ecuador? For if such policies are good for growth, why has the United States not adopted such measures? One remains curious as to how the IMF can justify uneducating an entire generation of Ecuadorian children. The reduction in Ecuador's

education budget is an imposition by the IMF, and it causes a good deal of unnecessary anti-American and anti-IMF sentiment.

B. Health Care

Although health care is supposedly provided free for all, in reality health care is a luxury of the rich in Ecuador. For example, at lunch one day, everyone went around telling stories (or jokes- depending on how you look at it) about health care in Ecuador. One of the priests noted that he had a receipt for prostate surgery -- in 2005.

Sardonically noting that the procedure was not urgent, he returned to eating his soup.

It should be noted that nearly all social services in the Tierra Nueva Foundation's neighborhood in Quito Sur are provided by the foundation, as government projects are simply non-existent. The social services provided by the foundation include day-care, health care, educational expenses for disadvantaged children, preschools, education for special needs children, legal counsel, and financial services. In order to expand these services, the foundation was developing a health insurance program for the residents of Quito Sur. The program was being designed by two Ecuadorian women (one of which was a business woman who had formerly been a top executive at an American hospital in Quito, the other of whom holds a master's degree in public health) and an American banker from Boston. It is revealing that the residents of Quito Sur needed such a program even though there is a law in Ecuador that mandates that all employers must provide health insurance for their employees.

This project of the foundation was originally what I would be working on while in Quito. But while developing the system, the group had run into several difficulties. First, as the target group of the plan was very poor and typically uneducated, many simply could not grasp the concept of insurance: it was very foreign to them. When the foundation would solicit the program to local groups and businesses, many people could not understand that the foundation would not return their monthly fee of \$2.50 per person if they did not need medical care. As well, employers faced terrible incentives for paying for the plan for their employees. As a result the group faced the problem of adverse selection; only sick people would want to pay for medical insurance, as they were the only people who knew that they would need medical care. And finally, the poor already have an insurance system. When someone falls ill, they simply sell some of their possessions and call on family and friends to contribute to help them pay off their medical costs. A man would contribute to a friend's medical costs fully expecting that the favor would be returned at some point in the future.

Thus as I spoke with those developing the health insurance program about the problems they were facing, they confided to me that they felt the whole project might not work in the end. Similar efforts had been made in other developing countries, but they had never worked. They also pointed out the dangers in the project. With adverse selection, the program could bankrupt the entire foundation. Even assuming that the project was a success, the degree of success might be very limited, as the program would only smooth the costs associated with medical costs. And since the poor already had their own system, the administrative costs (estimated to be tens of thousands of dollars per year)

would in large part do nothing more than add a financial burden on the poor and sick. As illustrated by all of these concerns, the foundation's health insurance project shows that we need to learn to create programs that accommodate the people on the ground in developing countries.

IV. Impediments to Change

A. Dollarization

On January 9, 2000, president Jamil Mahuad⁶ announced that Ecuador would replace its sucre with the US dollar as the country's official legal tender in order to combat the severe exchange rate depreciation recently witnessed by the sucre.⁷ This process, known as dollarization, officially began in Ecuador after its Congress passed the Law of Economic Transformation on March 13, 2000 [12]. An integral part of the plan for this transition was to mint fractional coins in dollar base denominations. But these coins were slow to come into circulation, which caused a shortage of change (along with general confusion) to lead vendors to "round up" their prices [10]. As a result, the price level in Ecuador has changed drastically since dollarization.

Before dollarization, one could feed one's self for two weeks to one month at the grocery store with one dollar's worth of sucres. Today, according to my host family, that dollar would not be enough for a week. To complement this testimony, I ate dinner with a man from Colombia whose father had been murdered by the Revolutionary Armed Forces of Colombia (FARC). He was astounded at the outrageous price of food in Ecuador. While he had to spend an exorbitant \$1.00 to get lunch in Ecuador (consisting of soup, juice,

⁶ Mahuad's plan to dollarize went against the advice of both the IMF [4] and his own Central Bank [10].

⁷ In early 1999, Ecuador's sucre traded against the US dollar at a rate of 7,000 sucres per dollar. By January 2000, the sucre had dropped to 25,000 per dollar.

rice, beans, fruit, and meat), back in Colombia 50 cents could fetch the same meal. And small luxuries have vanished to mark-up, as in the case of a street vendor who told of how she can no longer buy candy for her children.

While the current Gutiérrez administration appears to be content with the dollar, it is quite possible that dollarization will be overturned for Ecuador to return to a new sucre in the near future. A new sucre was a campaign promise of some presidential candidates, and according to a poll by one newspaper in Quito, 71% of Quito's citizens felt that dollarization had negatively affected them, and 67% would change their dollars for new Sucres [33]. The weakness with which dollarization has been performed only adds to the uncertainty and instability that will ultimately fuel inflation in a new sucre and in the rest of Latin America, especially considering that Ecuador is the largest economy yet to officially dollarize [10].

B. Government Corruption

After signing a peace treaty with Peru in October 1998, Ecuadorian president Jamil Mahuad enjoyed upwards of 60% of public support [4]. But then oil prices dropped in 1999, and Ecuador's economy crumbled: real GDP fell by more than 7%, unemployment sky-rocketed, the sucre lost over half of its value against the dollar, and poverty incidence (especially extreme poverty) shot up [28], [27]. As a result, Mahuad's approval rating fell to 9% by the end of 1999 [30]. Thus it did not matter that by April 1999, 80% of financial assets in Ecuador were dollar denominated [10]; when Mahuad decided to dollarize on January 9, 2000, he was ousted from office in

less than two weeks by an Indian uprising.

Mahuad's ratings fell in no small part due to public perception of the debt, which is the first subject in any political conversation with an Ecuadorian. At the same time he refused to testify before Congress *vis-a-vis* a controversy surrounding the final resting place of \$3.1 million in campaign contributions [31], Mahuad diverted over half of the government's budget in 1999 towards servicing the debt [36]. Thus while it is argued that debt relief and aid to developing countries should be conditioned on policies regarding the environment, population growth, and other issues with significant externalities affecting the First World [1], debt plays a bigger role in shaping policy than is considered by this argument. As pointed out in [16], the burden of debt destabilizes governments and is therefore often the greatest barrier to economic reform. Better policies will follow, directly or indirectly, from the responsible policies of democratically accountable governments enjoying the stability provided by debt relief. Only with a strong political base does Ecuador's government have hopes of pursuing serious economic reforms.

On the first day of inspections, I had an extensive discussion with Marco about politics and economics in Ecuador. We debated the role of the IMF, foreign investment, and micro-lending. Marco is evidently well-educated and cares deeply about the future of his country. Then I asked him about the upcoming fall elections (to be won by former army officer Lucio Gutiérrez), which I had seen plastered all over the newspapers. He looked at me and shrugged. Although voting is legally required in Ecuador, very few people feel

actively engaged in any sort of a democratic process.

By law, if one does not vote, then one cannot obtain a cédula. The cédula is a personal identification card that is necessary to find work, travel, make business transactions, or do nearly anything else that can be regulated by the government. As Ecuadorians are forced by the law to vote, many citizens such as Marco leave their ballot blank in protest.

Although there were more than 10 candidates in the presidential elections, Marco went through the list and found major problems with each candidate. There was not a single candidate who Marco could even remotely justify supporting. The resulting apathy creates a downward spiral in the Ecuadorian political process.

A quick glance at the recent presidents of Ecuador reveals the source of apathy of Ecuadorian voters. Sixto Durán, president elect in 1992, had a term remembered by Ecuadorians for its corruption and the massive protests lodged against his economic policies. Abdala Bucarám, president elect in 1996, was kicked out of office by Ecuador's Congress for "mental incapacity" [31] in February of 1997 following a 48-hour general strike. His term is remembered for authoritarian rule and incredible corruption. The successor to Bucarám, Fabian Alarcón, suspended the Supreme Court because it was investigating his actions. And then came Jamil Mahuad.

While he did believe that an "honest" politician could change Ecuador for the better, Marco did not believe that change would come in this way. Every taxi driver, doctor, priest, or vendor I spoke with agreed. As citizens' ability to influence their government

wanes, daily economic violence in Ecuador threatens to become physical violence. Thus since Ecuador tied (along with Bolivia, Cameroon, and Haiti) for 89th in a list of 102 countries in Transparency International's Corruption Perceptions Index for 2002 [35], it is no wonder that voter disgust and apathy often turn into direct physical violence. In fact, Ecuador has witnessed enough political violence that my Spanish professors would joke with me that all of Ecuador's previous presidents had been violently run out of the country for their corruption. My instructor Santiago joked that, "For me, Harvard is a synonym for 'bad presidents'." This joke merits some reflection, considering that Mahuad earned a law degree from Harvard [31] and was also a visiting professor at the John F. Kennedy School of Government at Harvard.

C. Security

As Dr. Martin Luther King, Jr. once said, "a mere condemnation of violence is empty without understanding the daily violence that our society inflicts upon many of its members. The violence of poverty and humiliation hurts as intensely as the violence of the club" [7, p.295]. This helps to explain why security is a mounting difficulty facing Ecuador. The economic violence inflicted on Ecuador is increasingly reappearing in the form of direct physical violence, as I experienced first-hand.

After I finished entering data into the computer I would usually have about fifteen to twenty minutes free before we would leave for inspections, so I would usually bring a book along to read. One day while I was reading Paul Krugman's *Peddling Prosperity*, specifically a section dealing with the Great Depression and bank runs, some commotion distracted me from my reading. I noticed people running and making all kinds of noise,

and I thought that it was a bank run. I wondered why people would run on the bank, as it seems like a novelty from a black and white movie. But then again, so do many scenes in Ecuador. By the time I bothered to look up, I noticed people diving onto the floor and hiding behind furniture. I glanced at the door and saw a jumble of people, along with a huge gun. Without seeing the assailant's face, I dove into a cubicle and hid under a chair as the bank was robbed.

The three men did not rob anyone of their possessions, and fired only one warning shot into the air. Other than badly scaring one lady, and inducing another lady to swallow her gold necklace in order to secure it from theft, the assailants did not harm anyone. After the robbery, as everyone laughed about the lady who had swallowed her necklace, I began to ask the workers at the bank, the security guard, and later even the priests at lunch about what had happened. While I had been expecting to hear anger and outrage, I heard a good amount of empathy and understanding. The security guard himself (who had just had a gun held to his head) explained to me that times were hard and the men probably had families to feed.

While he assured me that the agency he worked for was one of the top names in security in Quito, the security guard helped me to understand why even he could empathize with the burglars. Each guard had to go to security school and become certified before they could work for his company. Once certified, the men are assigned work by the company, which would contract out security.

It is interesting to note that on occasion, guards have been found to have discretely helped plan a robbery such as the one I witnessed. If we view this activity on the part of the guards as bribe collection, then we may apply the corruption model developed in [20].

The guards now represent bureaucrats, the bank (along with the other patrons of the security company) becomes an entrepreneur, and the top executives of the security company become the autocrat. We may view the demand for security from the company as the demand for permits from the government in the model, and the robberies may be seen as the price of the bribe to the patrons of the security company.

In [20], the authors let $k = a + V^L - t - V^I$, where a = the entrepreneur's return on investment, V^L = the value of a formal sector project (a project with security provided by the company), t = a lump-sum tax paid by the entrepreneur, V^I = the value of an informal sector project (a project without security), and n = the number of bribe setters. The authors find that if bribes are uncoordinated, then the total bribe price per entrepreneur is:

$$b_j^d = k/(1 + n). \quad (1)$$

If the bribes are coordinated, then the common bribe is

$$b = k/(2n). \quad (2)$$

By comparing (1) and (2), we may see that the bribe price per entrepreneur is higher if the bureaucrats' actions are uncoordinated than if they are coordinated. As this rent-seeking will always be decentralized (unless the company begins to help coordinate robberies as well, which we will assume not to be the case), we see that the quantity demanded for the company's services is smaller than if the guards were able to coordinate their actions and simply charge an extra fee. The authors further show that the best

option for the autocrat to reduce bribes, or for the company to reduce robberies assisted by their guards, is to pay a larger salary to the bureaucrats. Thus we may infer from the model that the company should get more business if it simply paid the guards a larger salary. [20]

Nevertheless, the guard at the MCCH was paid 25 cents an hour. He had absolutely no life insurance. As he explained it to me, if he were killed on the job, it would be as if a dog had died. He was personally liable for killing assailants, and if he failed to show up to work for a day, he would be fined \$22 by his company. He explained to me that the average Ecuadorian salary of \$1,300 a year (the CIA World Factbook says this average is \$1,210) is nowhere near enough to rent an apartment, pay for schooling, buy necessities, and feed a family. Although the guard has a “good” job, he works for a large company that has monopolistic control of the market for security guards and can therefore exploit its workers. The case for supporting micro-enterprises becomes more solid as one examines the economic opportunities provided by large companies with no economic incentives to care about the people of Quito Sur.

When the security company added another guard at the MCCH in order to avert a third assault, I began to feel the tension that I had felt while crouching under that chair in the MCCH. I have to admit that I felt a tinge of guilt when I left the MCCH to return to the US, knowing that the bank was liable to be assaulted on any given day. Although the bank was insured by the government against its losses, it had been robbed before this assault, and everyone fully expected it to be robbed again. But this is simply life for the

employees of the MCCH.

And as a final security concern in Ecuador, it is important to note that the drug war focused on Colombia is affecting the entire Andean region. Not only are Colombian refugees pouring into Ecuador, but Ecuador is becoming increasingly involved in the military conflict in Colombia. Nearly \$80 million has been spent on concrete reinforcement for the landing strip of the Manta Air Force Base in Ecuador (which was signed over to the US in November 1999), and the 550-KW aircraft is now being flown out of the base. Considering that this aircraft is capable of transporting an entire armed battalion, all of this activity strongly suggests that the US is using the Manta Base to stage military attacks in Colombia [14]. This increasing involvement means that even if we disregard the security concerns arising from economic violence in Ecuador, security is assured to become an increasingly pressing issue as the winds of war sweep over the Andean region and the rest of the world.

D. Foreign Investment

Although foreign investment brings wealth into countries, many in Ecuador view foreign investment as an impediment to development. Quito's theater is one example that might help to shed light onto the negative connotations associated with foreign investment. Located in the heart of Old Quito just beneath El Panecillo, the Bolivar Theater was founded in 1933. The theater had attracted internationally renowned stars and was one of the centers for culture in Ecuador, as it was home to a symphony, operas, ballets, plays,

and other performances.

When foreign investment began to appear in Old Quito, a Pizza Hut opened next door to the theater. On August 8, 1999, there was a fire from a gas pipe in the Pizza Hut, destroying 70% of the theater's facilities [32]. Although the theater continues to produce small events "over the ashes" [32], Pizza Hut refuses to pay for the damages caused by its negligence [25]. Since the theater has not been able to secure funding to rebuild, Pizza Hut has thus helped to ensure that much of the culture previously enjoyed by the city of Quito will not be available in the future.

Another small story concerning foreign investment and its effect on the poor may also show why foreign investment is seen to extract wealth. Oil companies have come to soak up Ecuador's vast reserves, so that driving by bus through the mountains, one sees oil pipelines littered everywhere in the Ecuadorian countryside. In 2002 the OCP⁸ Limited Consortium, made up of Alberta Energy of Canada, Kerr McGee and Occidental Petroleum of the United States, Agip Oil of Italy, the Spanish-Argentine Repsol-YPF, and Techint of Argentina began building a 600 km pipeline to transport crude oil from the Amazon Jungle to ports on Ecuador's Pacific coast. Under heavy pressure from the IMF, President Noboa submitted a proposal for 80% of tax revenues from the pipeline to go towards paying down the debt and 20% towards an oil fund (a fund that will be used to service the debt when oil prices drop). Showing at least minimal concern for its citizens, while at the same time staying away from Chavez-like taxation or expropriation,

⁸ Oleoducto de Crudos Pesados, or Heavy Crudes Pipeline.

the Ecuadorian Congress ratified a bill on May 22, 2002, appropriating 70% of tax revenues towards paying down the debt, 20% into the oil fund, and 10% towards health and education. [11], [19]

But when Ecuador was looking for a \$240 million credit from the IMF, the IMF conditioned the credit on Ecuador's diverting that 10% of revenues towards servicing the debt and away from social spending. And this is not to mention the fact that local and international environmental groups, indigenous communities, and the World Bank have all warned about possible environmental damage to pristine jungles and contamination of water supplies. It quickly becomes apparent why the average Ecuadorian detests the IMF. [11], [19]

E. Cultural Heritage/Racism

One theory for the difficulties of the transition to a market economy in Russia is that Russia is culturally averse to capitalism. While research has disproven this idea for Russia [18, p. 399], it might have more credence in Andean countries such as Ecuador.

For centuries, as written by John Hemming, “they [the Indians] had lived in a paternalistic society without money, personal property or writing. It was impossible for them to grasp that they were now regarded by the authorities as free individuals expected to earn money, compete, and stand up for their rights, if necessary by written Spanish law” [5, p. 352].

While time may have taught the Indians and mestizos (mixed Amerindian and white) to compete in order to earn money, time has not enabled the Indians and mestizos to compete with Ecuadorians of *European* descent. In this way the idea of self-improvement is somewhat paradoxical in Latin America: entrepreneurial will is not a problem, yet truly upward mobility is reserved for those of European descent. For example, as we hopped onto the bus one day, a living, breathing infomercial followed us. The man, donning a blue suit, began to inform the bus of the wonderful vitamins in his briefcase. After explaining the benefits to the body and describing the increase in energy associated with the vitamins, he passed around some boxes for the riders' personal inspection. After awaiting a response, the man left the bus in search of more customers on another bus. Although this man perfectly portrays the aggressive form of capitalism present everywhere in Ecuador, he will never become a top executive in his vitamin company.

Racism in Latin America is not the same as racism in the US. Nobody hates an Indian because of the color of his skin (as happens in the US), but rather it is simply understood that an Indian will never rise through the ranks of Ecuadorian society. This is why today's racism in Ecuador is just as harmful to social progress as racism was historically in the US while not being overtly genocidal in terms of direct physical violence. Since only 7% of Ecuadorians are of European descent⁹ [24], the distortion of incentives created by racism in Ecuador is very likely to be underestimated. With no possibility of upward mobility for the vast majority of Ecuador's population, Ecuador has yet to

⁹ The other ethnic groups are mestizo 65%, Amerindian 25%, and black 3% [24].

truly move beyond the feudalistic system inherited from its Spanish colonizers.

Considering the racial composition of other Latin American countries, racism plays a huge role in distorting incentives throughout Latin America. In Bolivia, Mexico, and Guatemala, mestizos and Indians make up 85%, 90%, and 98% of the population respectively [24]. Due to the racism prevalent in Latin America, none of these people will be able to achieve their true potential in a capitalistic society. Thus if the increase in freedom created by development is to be distributed among more than a tiny minority, then Latin America must witness a major social movement against racism before it may truly develop.

V. Conclusion

One can imagine the situation facing the brave and devoted workers at the Tierra Nueva Foundation in Quito Sur. Programs such as the bank of the MCCH have helped the poor to create wealth and contribute to the development of Quito Sur. Yet as the health insurance example illustrates, aid programs have an incredible ability to miss their mark and fail to help the poor (history is rife with such tales). And in the wake of IMF budget crunching, the burden of the provision of public goods such as health care and education in Quito Sur has fallen almost exclusively into private hands such as the Tierra Nueva Foundation. With inadequate budgets, these private hands face daunting obstacles such as government corruption, security concerns, and racism, which limit the effectiveness of even the best programs. Needless to say, these workers face incredible odds in their daily battle to improve the living standards in Quito Sur. But still they fight on.

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