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Poverty reduction in Ecuador

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Indigenous march in Ecuador. Photo: © Carlos Rodríguez Andes.

Case Study Summary

Material wellbeing

- The proportion of Ecuador's population who are living in extreme poverty (defined as surviving on less than \$1.25 a day) doubled from 10% in 1998 to 20% in 2000. This had fallen back to 10% by 2004 and to 4% by 2012.
- The incomes of the poorest 40% of the population grew by more than eight times the national average between 2006 and 2011. According to this measure, Ecuador achieved the world's most inclusive growth during this period.
- One of the countries in the Latin America and Caribbean (LAC) region with the lowest level of social expenditure in 2000, at 2.9% of GDP, this had risen to 4.7% of GDP by 2006 and to 8.3% of GDP by 2012.

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Why explore poverty reduction in Ecuador?

This case study illustrates Ecuador's progress in reducing poverty and inequality since 2000. The country was chosen on the basis of a quantitative analysis conducted for the Development Progress project at the Overseas Development Institute (ODI). This analysis showed that Ecuador was a country that had significantly reduced income poverty in relation to income growth over the 1990–2010 period. Between 1998 and 2012, the proportion of Ecuadorians living in extreme poverty (defined as surviving on less than \$1.25 a day) fell from 10% to 4% (World Bank's Povcalnet database). Income inequality, measured by the Gini coefficient, declined by 6 points (from 0.54 to 0.48) between 2007 and 2013, while the average for the LAC region fell by only 2–3 points (ECLAC, 2014).

Ecuador's success is particularly significant because it was achieved relatively rapidly in the context of sustained but unspectacular economic growth (averaging 5% per year between 2001 and 2006, and 4% between 2007 and 2012).¹ This growth was, however, highly inclusive. Indeed, between 2006 and 2011, Ecuador achieved the world's most 'inclusive' growth whereby the incomes of the poorest 40% grew by more than 8 times the national average.²

This case study explores the factors that enabled the reduction in extreme income poverty in the country, focusing on the changes in policies, politics and external circumstances that shifted the benefits of economic growth in favour of the poorer sectors. It offers insights into the reduction of extreme poverty in a resource-rich economy that has faced economic downturns and political transitions, and the associated challenges. The analysis draws on secondary literature, official documents, statistical databases and interviews with 16 experts on Ecuador.

What progress has been achieved?

Trends in income poverty

At the end of the 1990s, Ecuador was hit by three shocks, which prompted deep economic crisis – including a 6% contraction of GDP in 1999 (Central Bank of Ecuador) and a doubling of the number of people living in poverty. These were: (a) El Niño, a natural catastrophe in the form of heavy

rains that caused flooding and landslides; (b) a drop in the international price of oil, the country's primary export; and (c) a financial and banking crisis. The proportion of Ecuadorians living in extreme poverty rose from 10% in 1998 to 20% in 2000, dropping back to 10% by 2004 and to 4% by 2012 (World Bank's Povcalnet database).

Poverty measured by the national poverty line (which equates to about \$2.80 a day) followed a similar pattern: it peaked at 75.1% in 1999 in rural areas and at 36.4% in urban areas, but then declined steadily, reaching 47.3% and 15.5% in urban areas by 2014 (Figure 1).

There was also a reduction in chronic poverty: an INEC study found that it peaked with the crisis in 1999 (70% and 29% in rural and urban areas respectively), but had dropped to 36% and 10% respectively by 2014 (INEC, 2014b).

Poverty in other dimensions of wellbeing

The Human Development Index (HDI) is a composite measure of changes in three dimensions of wellbeing: health, education and income. Over the 1990–2013 period, Ecuador achieved progress in all three dimensions (UNDP, 2014): life expectancy at birth increased by 7.7 years (from 68.8 to 76.5); mean years of schooling increased by one year (from 6.6 to 7.6) and expected years of schooling increased by 0.3 years (from 12 to 12.3).³ The GNI per capita increased by about 50% (from \$6,772 to \$9,998, in 2011 PPP). As a result, the HDI rose by 11%, from 0.643 to 0.711, although Ecuador's HDI remained lower than the LAC average of 0.740.

Government policies are based on the recognition that poverty is multidimensional, the indicators of which also show progress. For example, the Index of Unmet Basic Needs (*Necesidades Básicas Insatisfechas*) combines deprivations in housing conditions, access to water and improved sanitation, the household dependency ratio and children's access to primary education. A household is considered poor if deprived in one or more of these dimensions. According to this indicator, the proportion of Ecuadorians experiencing multidimensional poverty fell from 65% in 1998 to 36% by 2014 (INEC, 2015).

Trends in inequality

The distribution of income in Ecuador remains unequal: in 2011, the country's richest 20% received more than half of national income (Figure 2). Income distribution has, however, significantly improved: over the 2000s, the total share of national income held by the poorest quintile rose from 3.2% in 2000 to 4.2% in 2011, while that of the top quintile fell from 61% to 52% (ECLAC, 2013).

The improvement in income distribution is mirrored by the converging distribution of indicators of living standards, basic health and education between the top and bottom quintiles – this holds true for access to safe water,

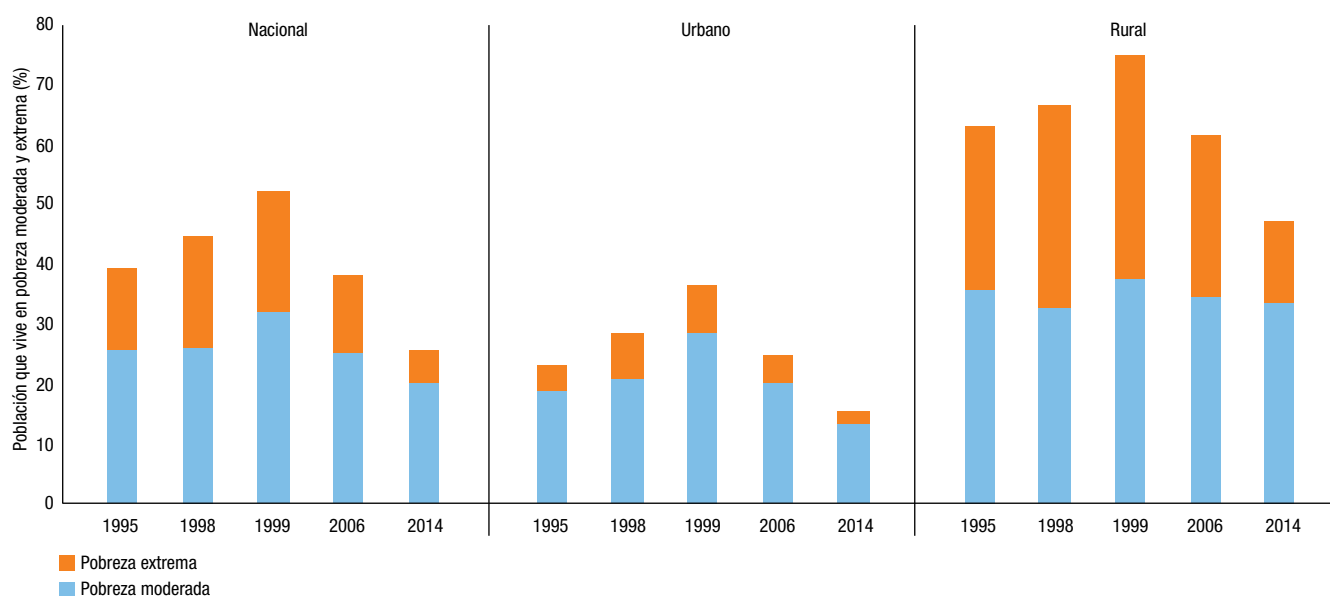
'The country has seen a reduction in inequalities, unlike any other country in the region' – Representative of an international organisation

1 Data from the Central Bank of Ecuador.

2 Computed from data in Global Database of Shared Prosperity, <http://www.worldbank.org/en/topic/poverty/brief/global-database-of-shared-prosperity>

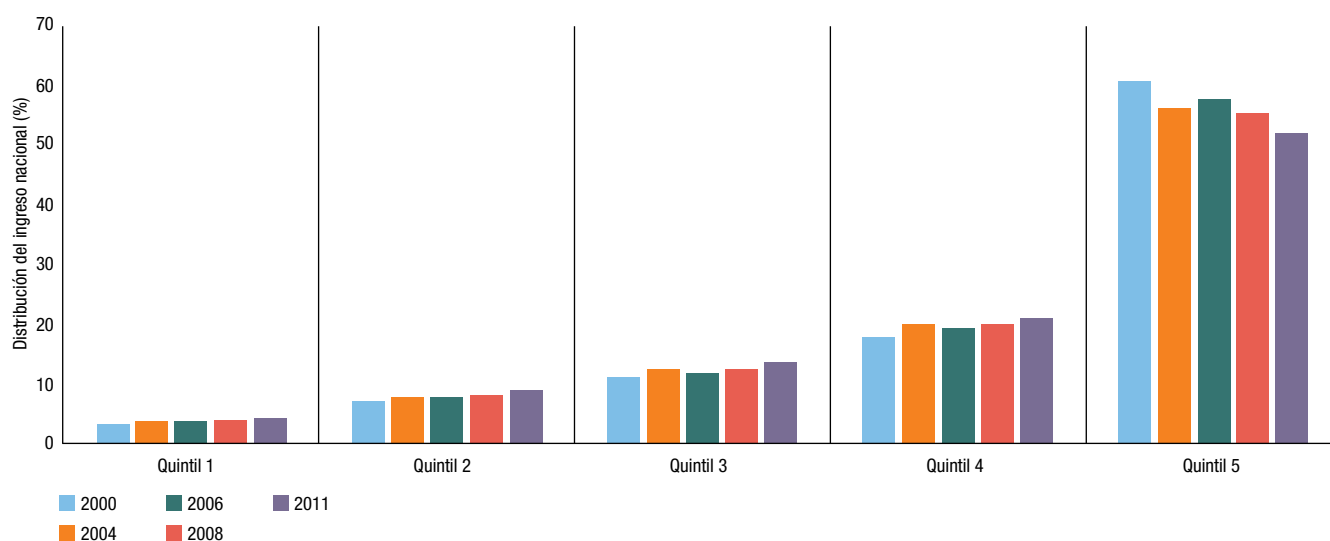
3 Mean years of schooling is the average number of years of education received by those aged 25 and older; expected years of schooling is the number of years of education that a five-year-old is anticipated to attain on the basis of net school enrolment rates.

Figure 1. Share of people living in moderate and extreme poverty in Ecuador, 1995–2014 (%)



Source: INEC (2014a).

Figure 2. Distribution of national income by quintile, 2000–2011 (%)



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

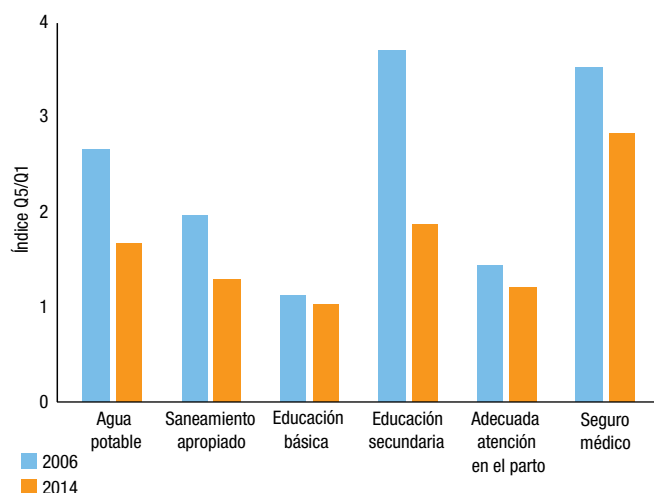
improved sanitation, primary and secondary education, skilled birth attendance and health insurance (Figure 3, overleaf).

In relation to inequality in consumption, a disaggregated analysis of the 2000–2014 period shows that poorer households experienced faster consumption growth than

households in the top deciles.⁴ In the 2000–2006 period, average yearly consumption growth was roughly 12% for all except the top decile, whose consumption grew at about 9%. From 2006 to 2012, the consumption of the bottom decile grew at almost 4.5% each year, and the top decile recorded negative growth of -1.7%.

⁴ Authors' calculations based on iresearch.worldbank.org/PovcalNet/

Figure 3. Living standards indicators: ratio of wealthiest to poorest quintile, 2006 and 2014



Source: INEC (2014b).

What are the factors driving change?

Ecuador's achievements in reducing poverty and inequality were made possible by a combination of economic and political factors, some of which were external and some domestic. The study identifies four main factors that have driven change.

1. Economic recovery accompanied by a period of macroeconomic stability

Ecuador's economic recovery and macroeconomic stability resulted from a favourable international context coupled with tough decisions in monetary and fiscal policy. In particular, the country adopted the US dollar as its national currency in 2000 as a means to stabilise the economy, together with a conservative fiscal policy until 2006. The high price of oil also enabled macroeconomic stability and recovery in guaranteeing a significant inflow of revenues (denominated in dollars).

How was this relevant for poverty reduction?

Economic recovery and macroeconomic stability triggered economic growth that led to a decrease in unemployment and an increase in wages. These effects were channelled to the poor because some of the sectors in which there was growth in the first years of the recovery – notably in agro-exports such as bananas and cut flowers – tended

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

to employ income-poor people. At the same time, dollarisation led to the appreciation of the exchange rate, which in the medium term resulted in the relative expansion of the service sector, which in turn absorbed a significant share of the poor urban labour force, especially in commerce and construction. Dollarisation also affected consumption, initially reducing the purchasing power of poor households but then improving it by cutting inflation and the relative price of imported goods (including food) that are an important burden on the household budget.

2. Changes in the labour market

Evidence suggests that after a plummeting of living standards immediately following the 1999 crisis (unemployment doubled to 14.5% and real wages fell by 25%),⁵ employment conditions in Ecuador began to improve. Domestic demand was the key driver of growth from 2000, and from 2007, the government increased coverage of social security and established a minimum wage. Unemployment fell steadily – reaching an average of 5% in the 2007–2012 period (ENEMDU data) – and wages increased, particularly for poorer workers. Over the 2000–2012 period, average wages increased by 75%, while the wages of the bottom quartile rose by 140%.⁶ The composition of the labour market shifted away from agriculture and towards services, although the share of agricultural wage labourers increased sharply. In addition, many Ecuadorians migrated overseas; by the mid-2000s, remittances accounted for 5% of GDP (Ponce and Vos, 2012) and they represent the second largest source of foreign exchange after oil (Jokisch, 2014). There has been little change in levels of informality, however, which have remained stubbornly constant – and account for anywhere between 50% and 80% of the workforce depending on how informality is defined (Canelas, 2014).

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

⁵ See Ponce and Vos (2012).

⁶ Computed from ENEMDU data cited in Canelas (2014).

How was this relevant for poverty reduction?

Wage earnings make up the largest source of income for households across developing countries (International Labour Organization, 2015). With growth and the sectoral shift in production, poor workers were more likely to gain employment, and employment shifted towards higher-value sectors of the economy, notably commerce and construction in urban areas, and agro-exports in rural areas. Wages rose, bolstered by a minimum wage policy which seems to have had some positive effects on poorer workers. The increase in social security coverage afforded additional protections to employees.

3. Radical political change towards strong government and redistribution

Between 1997 and 2006, Ecuador's highly unstable political system had led to constant changes in the executive, and a government that was unable to design and implement long-term policies. Between 2006 and 2007 the country experienced a radical shift in its political regime, marked by the election of President Rafael Correa, brought to power largely with the support of indigenous groups and other social movements (such as the women's movement, environmentalists and teachers). Correa's political regime has been characterised by (a) a strong government with a political strategy based on creating direct links with citizens; (b) a move towards redistributive social policies; and (c) radical measures to create fiscal space.

Correa's government has pursued a political strategy based on the establishment of a direct relationship with citizens – bypassing political negotiations by means of frequent electoral consultations and maintaining a strong focus on social policies and redistribution. This strategy originates in the combination of Correa's personal beliefs and political convenience with the push for change coming from large sectors of civil society. Popular pressure led to the adoption of a new Constitution in 2008 based on the ethos of *Buen Vivir*, or 'Living Well', which has three 'core areas': human development, harmony with nature and an economic model aimed at achieving sustainability, diversification and redistribution. The 2008 Constitution establishes 'Living Well' as the ultimate aim of policy-making and commits to the realisation of social and environmental rights and to collective citizenship. In order to create fiscal space and to finance social and redistributive policies, the government adopted radical measures to reform the management of public resources, including re-writing oil contracts to give the government the larger share of revenue, increasing direct taxes, restructuring the public debt and channelling all oil revenues into the budgeting process.

How was this relevant for poverty reduction?

The shift in the political regime described above was accompanied by an emphasis on redistribution and increased social expenditure, in particular (a) an increase in public

expenditure on social protection, health and education; (b) an effort to improve the quality of public services; and (c) an increased presence of the state by expanding social services beyond the main cities. All of these had positive impacts on the poorest and contributed to reducing poverty. Furthermore, a strong government that was committed to poverty reduction, and its need to adopt social policies to maintain public support, made it possible to redistribute national wealth. Otherwise, this would have been difficult to do. This is illustrated by the fact that poverty reduction was driven mainly by economic growth between 2000 and 2006 and by redistribution thereafter (INEC, 2014b).

4. Strengthening of the social protection framework and social services for the poor

After 2007, an expansionary fiscal policy enabled an increase in public spending on health and education, and the expansion of social protection for a broader segment of society, especially the cash-transfer programme *Bono de Desarrollo Humano*. From a low of 2.9% of GDP in 2000, social expenditure reached 4.7% in 2006 and 8.3% in 2012 (CEPALstat database). Increased expenditure was accompanied by efforts to improve the provision of services in the poorest and most remote areas.

How was this relevant for poverty reduction?

The *Bono de Desarrollo Humano* had a number of positive effects on the poorest social sectors – for example, improved child nutrition, increased household consumption and higher school enrolment rates. The expanded investment in health and education had a direct impact on poor people, who experienced improvements in these areas and were better able to satisfy their basic needs. The provision of many of these services for free at the point of delivery had a positive effect on the incomes of the poorest by reducing the need for out-of-pocket expenditures.

What are the challenges?

Today, Ecuador faces the challenge of advancing and deepening the progress it has achieved in the context of changing domestic and international circumstances.

1. Tackling persistent poverty

Further reduction of poverty will depend on paying greater attention to social sectors that have not fully shared in the benefits of growth. For example, poverty is still overwhelmingly a rural phenomenon – in 2014, nearly 50% of the rural population was poor in relation to the national poverty line, compared with about 14% in urban areas (ECV data), and the ratio of rural–urban chronic poverty reached a high of 3.6 in 2014.⁷ It is also significantly higher in the Amazon region than elsewhere in the country (nearly twice as high as in the Costa and Sierra regions) as a consequence of the lack of (or limited)

⁷ Computed from data in INEC 2014b.

public infrastructure, adequate housing, health services, agricultural cultivation and diversification of productive activities (Senplades, 2013). Indigenous groups are far more likely to be poor: 65% of the population compared with 30% of the Afroecuadorian population and 21% of the Mestizo population, respectively (INEC 2014c).

2. Fully implementing the principles of *Buen Vivir*

The country also faces the challenge of advancing in the three core areas of *Buen Vivir*, the principle enshrined in its Constitution. A key issue is matching the efforts put into adopting social policies to advance human development with advances in the transformation of the economy and protection of the environment. Notably, while oil price increases have been a central factor in enabling higher social spending, dependence on the exploitation of natural resources has deepened, pushing the country towards an unsustainable development strategy. Another concern is the loss of traction for the realisation of some core objectives of the *Buen Vivir* agenda, especially participatory policy-making through direct citizen involvement and the recognition of political and cultural autonomy for Ecuador's different ethnic groups to make the country a pluri-national state. The government has shown an increasing lack of commitment to their implementation and has been criticised for reducing the freedom of civil society organisations (CSOs).

3. Economic diversification and creation of employment

Future progress will require economic diversification and the creation of job opportunities for skilled and unskilled workers. Dollarisation and the high oil price have so far reinforced a model of export-led growth based on traditional exports (e.g. oil, shrimps and agricultural commodities). There has been a significant creation of

jobs in the service sector, but many of these are in the informal economy and have a low rate of productivity. In the absence of a national currency, promoting sustainable growth based on non-commodity exports will require heavy investments to increase the country's productivity, which has continued to lag behind that of other LAC countries (OECD, 2013).

4. Maintaining high levels of social spending while navigating economic downturns and political transitions

In recent years, public finances have come under pressure owing to the fall in the international price of oil, resulting in lower government revenues and foreign currency inflows. The situation is aggravated by the absence of a national currency and of reserves saved from previous oil funds, as these have now been spent. Ensuring that improvements in human development benefit all social sectors – including those still experiencing marginalisation and discrimination – requires that levels of social expenditure keep rising in line with the LAC average. To make this possible, the current and future governments will have to better allocate resources to allow for redistributive public spending as well as adopting prudent fiscal management and saving resources for future generations.

Other challenges are political. Rafael Correa's third and final presidential term will end in 2017. During his governments, political priorities and policies were not agreed through broad political negotiation, but were approved thanks to the overwhelming majority of Correa's party in the executive and legislative. The current situation is 'collaborative enough' to maintain power and propose policies, but there are signs that political instability may re-emerge. Future governments may challenge the political and economic strategies of the past and reverse some social policies, at the risk of undermining some of the progress achieved in reducing poverty.

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

Lessons learned

- **An explicit focus on inclusive policies beyond economic growth is essential in order to reduce poverty and inequality.** These can be achieved even with moderate rates of economic growth, if a country redistributes jobs, income, and resources through poverty-focused social expenditure. Ecuador's recovery from the economic crisis was critical to its poverty-reduction achievements. Various policies were designed to benefit the poorest households, such as cash transfers, free education and health services, and regulations to improve wages and working conditions.
- **It is possible to create fiscal space for social expenditure through 'unconventional' measures, provided there is sufficient political will and commitment to redistribution, but to prevent negative macroeconomic consequences they should be employed in the context of counter-cyclical macroeconomic management.** In Ecuador, increased social expenditure was associated with radical reforms in public resource management and the creation of fiscal space through measures such as restructuring the foreign debt and increasing royalties from oil extraction. Such measures were not, however, accompanied by counter-cyclical management and in the context of changed external economic conditions, the government faces severe constraints on its spending capacity.
- **Countries that are rich in natural resources can create considerable fiscal space by using export revenues to finance public investment and social policies.** It is also necessary, however, to balance current spending with future needs and therefore save part of these resources. Having spent all previously saved oil revenues, Ecuador's government can face the drop in international oil prices only by increased borrowing or reduced spending.
- **A strong government, political will and commitment to inclusion and redistribution make it easier to increase social spending and to implement programmes for excluded social sectors.** They are not, however, conducive to progressive social change if they are accompanied by the closure of spaces for civil society participation. The initial traction demonstrated by Correa's political regime for bottom-up, participatory policy-making has been replaced by authoritarian tendencies, compounded by the closure of spaces for CSOs to participate. These tendencies undermine the country's progress towards a more equal and democratic society.
- **Favourable economic and political conditions can compensate for the lack of structural change in the economy and society for a limited period – but ultimately eradicating poverty and sustainably reducing inequality requires removing their structural causes.** The combination of dollarisation with oil reserves in a context of high oil prices created the conditions for growth and economic recovery – but they also reduced the incentives to promote a diversification of the economy towards tradable, labour-intensive manufactured goods and to invest in productivity. In the context of declining oil prices and lack of a national currency, it is more difficult for Ecuador to maintain a sustained path of economic growth and to diversify the economy in order to create job opportunities for all sectors of society. Eliminating discrimination and the exclusion of traditionally marginalised sectors is essential in order to ensure that economic transformation does not lead to greater inequality. Ecuador faces the challenge of advancing this structural change in a context of adverse economic and political conditions.

This summary is an abridged version of a research report and one of a series of Development Progress case studies being released at developmentprogress.org

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