

# Ecuador: Reforming Against the Odds

**I**n Ecuador, deep-rooted corruption has been thwarting efforts at macro-economic and other reforms for much of the 1990s. Each time the reform movement started to take off, it was snagged by allegations of corruption that toppled successive government leaders.

When ANDE responded to the public clamor for change with an anti-corruption program in 1997, unhappiness with corrupt governments was at a high point (see box on previous page). Democratically elected President Abdala Bucaram had recently been removed, after only six months in office. A broad cross-section of civil society—from unions to indigenous groups—staged protests and general strikes

over the hardships of his austerity plan and revulsion over the degree of nepotism and corruption pervading his administration. More than an uprising against Bucaram, these events were an expression of dissatisfaction with the way in which the country was being managed.

Over the years, corruption has penetrated deeply into most of Ecuador's major governmental institutions. The judicial system had become so inefficient, politicized and corruptible as to obstruct the proper functioning of democracy rather than supporting it. For example, judges have been widely accused of involvement in drug trafficking and other illegal activities.

To counteract the prevailing public cynicism and to reignite the

country's stalled reform agenda, ANDE's "Strategies for Reducing Corruption" project looked to constructively link corruption prevention to a larger strategy for institutional modernization. The approach was to create consensus for concrete actions by bringing a targeted group of stakeholders into the process and then working to build broad constituent support.

The project trained its sights on six general areas that had become focal points for the most egregious forms of corruption and therefore were in greatest need of action: administration of justice, procurement, customs, privatization, social security, and financial management and budgeting. Abuses by government officials in these areas were

# Brazil: Reducing Transaction Costs

**C**orruption scandals involving high-ranking officials have erupted in many Latin American countries in recent years, but those affecting Brazil have been among the most high profile. Charges of corruption led to the impeachment of President Fernando Collor in 1992 and the indictment of scores of Brazilian congressmen in 1993. The scandals created a high level of public cynicism toward Brazilian politicians, undermined public faith in the country's democracy, and highlighted the weaknesses in Brazil's governmental institutions—legislatures, courts, regulatory agencies, and the police force. In the economic arena, it has weakened public support for the government's economic reforms by undermin-

ing the legitimacy necessary to implement unpopular austerity measures.

In 1995, CIPE and the Liberal Institute of Rio de Janeiro (ILRJ) launched a project to address this problem by examining how corruption creates high transaction costs related to government policies, practices and structures. Linking corruption with transaction costs tied in neatly with initiatives other reform-minded groups active in Brazil were already pursuing. Various private sector groups, in particular Brazil's National Confederation of Industries, coined the slogan *Custo Brasil* to mobilize support for measures to reduce the high transaction costs that make Brazilian goods less competitive in the global marketplace.

In recent years, most Latin American governments have confronted major corruption scandals involving current and former high-ranking officials. Corruption has weakened public support for democratic institutions in many countries as well as for economic reforms by undermining the legitimacy and support necessary for governments to implement often unpopular austerity reform measures. This is particularly true in Brazil, where scandals have produced public cynicism towards Brazilian politicians, undermined public support for and faith in the country's return to democracy, and highlighted the weaknesses in Brazil's governmental institutions—legislatures, courts, regulatory agencies, and the police force. Corruption

closely tied to the country's recent governing crises.

The corruption fighting strategy developed for each area started with a diagnostic study examining the environment that gave rise to abusive bureaucratic behavior. Each of the six studies contained a historical, empirical and institutional analysis of the institutions and the issues. They identified approaches to address the problems, especially corruption; they framed concrete short- and medium-term reform recommendations; and they suggested longer-term strategies for reaching the objectives.

Each diagnostic report was prepared by a recognized expert experienced with similar reforms in other countries or contexts. The privatization report, for example, gained enormous credibility because it was drafted by Alfonso

Revollo, the key architect of privatization in Bolivia and who was Minister of Capitalization.

### Double-barreled outreach

To generate the best ideas while at the same time securing support for study recommendations, the project brought together prominent stakeholders at two key points. During the diagnosis preparation stage, each expert preparing a study moderated a working luncheon. Attending each session were about a dozen well-chosen persons from inside the government and outside who would have a direct stake in the outcome.

The process had several advantages. For one, it built a consensus among the stakeholders about what needed to be accomplished. For another, it produced a technically proficient document accessible to a

relatively wide audience. The consensus reached in each case was reflected in the final study, with the participating stakeholders acknowledged at the end of the document.

To further enhance the impact and broaden ownership, the same stakeholders were brought together for a second working luncheon at which the final document was reviewed and presented to the press. This presentation was followed by broad dissemination of the results, further discussion and integration with studies and projects by other stakeholders and donors. ANDE expected that diagnostic studies containing recommendations generated by the stakeholders directly affected would simultaneously create strong demand for immediate, concrete action and enlist support for broader underlying reforms.

The project studies, which advo-


has deep historical roots in Brazil and other developing countries. It has been characterized by Max Weber as the phenomenon of patrimonialism (statism) which Brazil inherited from Portugal, further developed during the presidency of Getulio Vargas in the 1930s and modernized during the 1960s and '70s by the Brazilian military. Such statism does not provide for participation of citizens in the decision-making process and, according to Dr. Douglass North, there are high transaction costs associated with such closed political and economic institutions.

The CIPE-funded ILRJ project, "Reducing Transaction Costs in Brazil," was designed to study the causes of high transaction costs and to recommend policies to lower them as part of a vigorous advocacy program. The three areas explored—government procurement,

the labor courts and the privatization-related regulatory environment—were explicitly related to the Confederation of Industries' ongoing *Custo Brasil* effort. In two of the three studies undertaken a sound set of policy recommenda-

tions helped to stimulate policy reform. Only in the new regulatory regime governing privatization did the empirical data prove too scant to justify recommendations.

Government procurement is notoriously susceptible to corruption.



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cated specific legislative, institutional and constitutional reforms designed to reduce opportunities for corruption, fell on fertile ground. A World Bank-financed National Anti-Corruption Action Plan was under development at the time the studies were made public in 1998. The recommendations of each study were incorporated almost verbatim in the country's proposed Action Plan, which was endorsed by Ecuador's deposed President, Jamil Mahuad, in early 1999.

In addition, the intermediate action options and strategy have also been taken up by the country's Civil Anti-Corruption Commission. Widespread public support for the proposals, which served to clarify reform issues, also is evident. Several of the recommendations (regarding cus-

toms, comptroller and judiciary modernization, for example) have strong public backing.

### Hamstrung by politics

ANDE hoped that if solid recommendations supported by a significant constituency were put on the table, the specific measures as well as the broader strategy would be taken up eventually as political circumstances allowed. To date, however, the reform plan remains mired in political dissension.

Hopes for progress on these critical fronts rest on the fate of the *Ley Marco*, legislation that the executive branch is negotiating with Congress. The law would give the executive broad authority to negotiate privatization and implement other key reforms, as well as endow the Civil Anti-Corruption Commission with the authority to

implement anti-corruption measures. Passage of this law remains highly uncertain. And some are concerned that the political deal-making entailed could spawn a whole new wave of scandals.

### What's needed now

While searching for a window of opportunity in the political environment, ANDE is continuing to create a broader base of support for the specific anti-corruption measures it has put on the table, as well as for the integrated reform strategy Ecuador needs. Accordingly, it plans to intensify consensus-building with a larger group of stakeholders in order to build a constituency for sustainable change. Also needed is more outreach work to stimulate awareness among the press, unions, youth, consumer and other groups. Bring-

If there is a lack of transparency and accountability in bidding on government contracts, corruption can easily take root in the process. The result is higher cost of doing business, which generally translates into higher prices to the consumer and eventually lower income for government to pay for social services that benefit the public.

### Shedding Light on Procurement

A procurement study prepared by the ILRJ examined international experience regarding government purchases and looked at Brazil's own legislation. Its evaluation of Brazil's existing rules underscored the cost of lack of transparency and competition. The study's detailed and substantive empirical data strongly supported specific policy recommendations and changes in Brazil's laws.

Seven of the 11 specific recommendations offered from the study data have been adopted by law or by government decree and an eighth recommendation was incorporated into a broad draft bill on fiscal responsibility. Policies adopted include:

- ▶ better dissemination of bidding rules (including creation of a rules database);
- ▶ reduction of the discretionary power of purchasing agents through enhanced transparency;
- ▶ better definitions of decision-making authority;
- ▶ more competition among contract bidders;
- ▶ broader criteria (beyond just lowest price) for evaluating proposals; and
- ▶ waiving bidding requirements in urgent-need situations.

In contrast to other countries that have strong, independent branches of government, Brazil's inefficient and politicized judicial system breeds corruption. The transaction costs associated with settling commercial and labor disputes are high. Labor mediation is conducted in a way that inhibits the bargaining process and puts a premium on conflict rather than resolution. The study's recommendations on reforming the labor courts were developed from extensive empirical evidence on the number and length of labor court cases and the cost of conducting them.

Of the major recommendations offered by the study, two were adopted and are now reflected in new laws. The first instituted arbitration in commercial cases to reduce their number and duration. This reform represents an important precedent for settling labor

ing these groups into the process would enhance social capital, strengthen the democratic process and encourage public support for institutions.

Also on ANDE's agenda is a stronger focus on implementation of specific reforms. It expects to help develop an effective and credible implementation mechanism for the National Anti-Corruption Action Plan and other reforms.

ANDE is well positioned to act on both these fronts. When it comes to strategies to counter corruption, it has long been at the forefront in facilitating consensus among a network of civil society organization—from consumer to religious groups. Its prestige was further enhanced by the activities connected with the CIPE-sponsored anti-corruption project. ANDE is now represented on most of the

mixed government-private and civil society review boards that play a role in guiding privatization and other key reforms. This network of nonprofit groups will likely continue to spearhead greater consensus on key institutional, privatization and anti-corruption reforms.

ANDE's role as facilitator of civil society consensus on reform issues has given it credibility with the wider public, the press, legislators, members of the executive branch, and representatives of the international community. That puts ANDE in a good position to help effect both discrete technical changes to reduce corruption opportunities and development of a broad and integrated reform/modernization strategy.

What happens next to the reform proposals will depend largely on the extent to which the execu-

tive and the legislative branches can come to terms. Whatever the level of this agreement, the project has generated a framework for change, set out some specific options and created a degree of operational cohesion needed to ensure progress. Whatever the fate of the *Ley Marco*, the active network of nonprofit organizations into which ANDE is closely tied should play a pivotal role in building the social trust to implement reform and anti-corruption measures. 🌐

disputes. The second policy recommendation was adopted in May 1999 to abolish the requirement for *classista* representatives. This policy curtailed the activities of labor lawyers whose involvement in these cases increased the cost and length of court proceedings.

### Launching an Advocacy Effort

After the three studies on procurement regulations, labor court reform and deregulation were published, two day-long conferences were held in Brasilia and São Paulo to present the findings and recommendations. The goal was to elicit press coverage and build awareness on the need for reform, particularly among key members of congress. Over 100 officials attended the September 17, 1996 conference in Brasilia. That meeting was organized into three panel discussions (one each on

labor courts, procurement, and deregulation) with presentations by experts in these areas. A second conference, held two days later in São Paulo, was organized in a similar fashion but attracted a smaller audience.

Several factors propelled the implementation of the policy recommendations for reforms of the labor courts and procurement procedures. The high cost and dubious utility of labor courts and the antiquated, inefficient procurement system had long been the focus of concern among many key stakeholders. Reform efforts in these areas had already gone through several cycles making it more apparent that these recommendations presented the most likely way to achieve action. Moreover, articles appeared in the press at the same time detailing the corruption surrounding

the labor courts, and they effectively generated public demand for change.

### Pointers for the Future

Much of ILRJ's success in promoting implementation of reform policies rested on the weight of its intellectual arguments, and the fact that these were delivered for the most part to ideologically friendly government officials and legislators, and in alliance with the Confederation of Industries—a natural and longstanding ally.

A deteriorating economy has left President Fernando Cardoso in political trouble since his reelection in late 1998. His popularity ratings have sunk to record lows and his cabinet is in disarray. Key tax reform measures are floundering as the support he received from the four-party coalition that backed him in congress has begun to flag.

A center-right congressional majority is for the first time experimenting with taking the reform initiative, with special legislative commissions preparing tax and judicial reform proposals. However, campaigning for municipal elections to be held late in the year will soon supersede reform considerations.

Now the challenge for ILRJ will be to alter its approach in keeping with Brazil's changing reform environment. In addition to identifying other bureaucratic areas ripe for reform, engaging a broader range of potential constituencies may be needed if a wide-ranging reform agenda is to succeed. To date, in-

dustry has been the major champion of the reforms ILRJ has proposed. A potentially vast constituency, mainly labor and consumers, could be convinced to support these initiatives if a clearer connection between lower transaction costs and improvements in employment and consumer prices is drawn. 🌐

## Evolving Role for Brazilian Think Tank

The activities of the Liberal Institute of Rio de Janeiro (ILRJ), founded in 1983 as a nonpartisan forum for the discussion of problems that affect the establishment of a market-based democratic society in Brazil, have expanded greatly since its association with CIPE began in the early 1990s.

ILRJ publishes, translates, edits, and distributes books and pamphlets on market economies. It also sponsors conferences and seminars and participates in international forums. With financial and technical assistance from CIPE, ILRJ launched an economic advisory service in 1990, which continues today on a self-sustaining basis. Later, CIPE support enabled ILRJ to begin publishing a monthly series of diagnostic studies, or *Notas*, on key national issues ranging from constitutional reform to fighting poverty. They advocate measures to improve public services and economic performance by combining theory, empirical data and region-by-region analysis.

These studies, along with research published in the institute's quarterly magazine *Think Tank* and in-depth white papers, have been systematically distributed to key stakeholders in and out of government. These publications and related seminars have contributed to the liberalizing trend in Brazil by offering groundbreaking policy options.

ILRJ's capabilities that made it an appropriate partner for CIPE's transaction-cost reduction project in Brazil include its experience in:

- producing in-depth diagnostic studies on key policy issues;
- organizing conferences aimed at implementing specific policy recommendations; and
- lobbying in conjunction with like-minded stakeholders for legal and policy changes.

The institute's diagnostic studies have earned it a reputation for professionalism. Many regard it as very effective in buttressing the case for reduced state intervention as a means to improved public policy. The current goal for ILRJ is to become an integral partner in broad strategic alliances for ongoing substantive change such as the one it forged with the Confederation of Industries in the *Custo Brasil* effort.

*These two articles are based on independent evaluations conducted by David Pezzullo. The evaluations pointed out how these projects represent important efforts at leveraging private sector involvement in reducing corruption. It also describes how well-reasoned policy programs to achieve this goal can be undermined by weak advocacy programs. The full text of these evaluations is available on CIPE's Web site at [www.cipe.org](http://www.cipe.org).*