

# Governance in the Andean Countries<sup>1</sup>

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## Introduction

Governance--the means by which a country exercises authority--determines how a society organizes institutions, regulates behavior, and distributes resources.<sup>2</sup> Better governance in the form of bureaucratic efficiency, strong rule of law, transparency and accountability affects how other aspects of a society develop. How we define governance and what we mean by its improvement is critical to identifying where a country's future resources ought to be concentrated. At the outset we must be clear that the term governance is not synonymous with democracy. Democracy, as a political system, is minimally defined as "rule by the people." The concept of governance is broader than that of democracy incorporating various types of political systems including authoritarianism.

Democracy as a political system is relatively new to the Andean countries with reversions to military authoritarianism.<sup>3</sup> Instability has been a feature of these countries' political regimes since their independence beginning in 1819. Civilian governments have been the exception; military coups have been frequent; and various reformist and leftist parties have at one time or another been repressed, harassed or otherwise prevented from participating freely in the political system. Beginning in the early 1980s this pattern was altered toward more stable democracies, except in the case of Peru where a reversal has taken place.

Some observers of Latin American politics argue that the region is on the cusp of a reverse wave. Democracy is declining in several countries as political and civil liberties are eliminated in attempts to control social unrest, guerrilla movements, organized crime, weaken political opposition and eliminate corruption. Others see a selective reversal or individual deviations from the democratic path. They argue that one only has to look at the recent elections in Uruguay and Argentina, and the countries of Costa Rica, Chile, and El Salvador to see the functioning of vibrant democracies in Latin America. Generalizations about democracy are difficult to make yet it is obvious that certain institutional aspects of democracy—the judicial system—are key to good governance and economic growth. The Andean countries face serious challenges to improving the autonomy and efficiency of their judicial systems. It is unclear, for example, in the case of Peru, when and if an independent and merit-based judicial system will exist.

Yet, governance has been changing in Latin America and sufficiently so to contribute to enduring democracies. What are these aspects of governance? Do they have

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<sup>1</sup> Background paper prepared for the Andean Competitiveness Project, January 2000.

<sup>2</sup> Aristotle, *Politics*, Book ii, 7.

<sup>3</sup> The most recent transitions to democratic political systems took place in 1979 in Ecuador, 1980 in Peru, 1982 in Bolivia, 1965 in Colombia, and 1961 in Venezuela.

any relationship to the economic development of a country? In this section on governance, both the political aspects of governance--electoral systems, political parties, rule of law--and the technical aspects--efficiency and public management--will be discussed and analyzed for the five Andean countries. The discussion also examines a third component--civil society. Relying on data from various sources and the aggregate governance indicators of Kaufmann, Kraay and Zoido-Lobaton (1999), the five Andean countries will be ranked on governance issues. A priority of the Andean Competitiveness Project is to examine the causal relationship that exists between improved governance and increased economic performance. In this section we will discuss political institutions, the functions they perform, and *how* they perform them and suggest what aspects directly affect a country's economic performance.

### **The Governance Databases**

The Kaufmann, Kraay and Zoido-Lobaton governance database relies on fourteen databases containing over 300 variables on governance topics. Variables that measure similar basic concepts are clustered under an aggregate governance indicator of which there are six: voice and accountability, political instability and violence, government effectiveness, regulatory burden rule of law, and graft.<sup>4</sup> Relying on the Kaufmann, Kraay, Zoido-Lobaton aggregate governance indicators as well as other databases, we establish benchmarks for the five Andean countries on governance and its relationship to economic growth.

In addition to the Kaufmann, Kraay, and Zoido-Lobaton indicators, we include in the analysis results from the opinion poll Latin Barometer measuring public perceptions of government (discussed under aggregate governance indicators 3, 4, 5, and 6), data from Polity III and Polity 98 measuring the performance of the executive (discussed under aggregate governance indicator 3) and Coppedge's database on political parties (discussed under aggregate governance indicator 1).

Furthermore, we explicitly discuss within the Kaufmann, Kraay and Zoido-Lobaton's six aggregate governance indicators the role of the military in politics, the decentralization of the state's administrative and financial responsibilities, the nature of democracy and the state of civil society. We conclude by summarizing the findings for each country.

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<sup>4</sup> The databases are: Business Environment Risk Intelligence (BERI), The Wall Street Journal Central European Economic Review (CEER), Standard and Poor's DRI/McGraw-Hill (DRI), European Bank for Reconstruction and Development (EBRD), The Economist Intelligence Unit (EIU), Freedom House (FHFV, FHNT), Gallup International, World Economic Forum (GCS, GCSA), Heritage Foundation/Wall Street Journal (HFWSJ), Political Risk Services, International Country Risk Guide (PRS/ICRG), Institute Management Development (WCY), World Bank/University of Basel (WDR).

## **Measuring Governance in the Andean Countries**

One of the primary challenges confronting economic development in the Andean countries is their political system. For these countries to promote economic growth while addressing social conditions requires continuous, stable political situations. This subsection is a stock taking of how the five countries stand on governance and political issues as defined and measured by various data sources.

### Voice and Accountability

The voice and accountability category covers a number of indicators measuring various aspects of the political process, civil liberties, and political rights. These indicators measure the extent to which citizens of a country are able to participate in the selection of government. Included in this category are three indicators measuring the independence of the media. Freedom from fear, freedom from arbitrary arrest, the ability to practice free speech, free association, as well as the freedom to run for and obtain public office, can all be viewed as necessary elements to being a citizen in a democratic society.

The Freedom House Survey of Political and Civil Liberties ranks Bolivia out of the five Andean countries as permitting the most political freedoms. Ecuador, Venezuela, Colombia, and Peru rank, respectively, from less than that of Bolivia to, in the case of Peru, lacking significantly in political freedoms. On the Kaufmann, Kraay, and Zoido-Lobaton scale of aggregate governance indicators, Bolivia ranks the best with Ecuador second on permitting voice and accountability. Peru is the worst off in terms of upholding political and civil liberties. Colombia is second worst with Venezuela in the middle. Thus, there is agreement on the ranking of the countries in terms of political and civil freedoms: Bolivia, Ecuador, Venezuela, Colombia, and Peru.

Taking the date of the most recent transition to civilian rule in each country as the baseline—Bolivia 1982, Colombia 1965, Ecuador 1979, Peru 1980, and Venezuela 1961—we can chart how well democracy has done by looking at political and civil liberties. In Bolivia and Ecuador liberties have dramatically expanded. By contrast, Colombia has seen in the last two years a restricting of political and civil liberties. Peru, upon its return to civilian rule in 1980, permitted political and civil liberties. With Alberto Fujimori's election in 1990, a rapid decline in liberties took place. Venezuela, from 1992-1997, saw a downward shift in political and civil liberties. This was in large part due to the 1993 political and economic crises surrounding President Andrés Pérez and their aftermaths. After 1997, political and civil liberties slightly improved. Whether Venezuelans will continue to enjoy the same level of political and civil liberties remains unclear under the new executive Lieutenant Colonel (ret.) Hugo Chávez Frias.

Argentina, Chile, and Uruguay rank high on political and civil liberties. Uruguay and Bolivia have enjoyed for the last three years a rating on political liberties as high as that of the United States. For Bolivia, this is an impressive improvement given its past record of political instability and violence. Looking at the long-term trends, one

concludes that Uruguay since 1985 has been consistently upholding political and civil liberties. Uruguay, with Malta, enjoys one of the highest voter participation records in the world and the highest in Latin America. And, Bolivia is well on its way to upholding political liberties.

Peru, since the election of Fujimori in 1990, has seen a continual deterioration in political liberties and to a lesser extent in civil liberties. Colombia, also since 1990, has experienced deterioration in civil liberties. Whereas ratings for political liberties improved slightly from 1992-1994 but then worsened. Ecuador, except for the political crisis of 1995, has remained fairly consistent in upholding political and civil liberties. There is not an improvement but neither is there deterioration in liberties. Chile's ratings are slightly higher than those of Ecuador. Yet, like Ecuador's ratings, Chile's have remained constant since 1990.

A recent study looking at the effects of citizen participation in elections on economic growth conclude that in Latin America higher voter turn out induces higher government transfers. And, these transfers negatively affect the distribution of income. In other words, government programs tend to favor the wealthy (Mueller and Stratmann, 1999). Since citizen participation in elections has an indirect effect on income inequality by increasing government size and transfers, and since government size reduces the growth of Gross Domestic Product (GDP), citizen participation also leads to a reduction in economic growth.

Compelling citizens to vote does raise the percentage of participation in elections. (In Latin American countries penalties on nonvoting increase voter turnout by seven percentage points *ceteris paribus*. This represents an increase of slightly 10 percent of the mean turnout level in the Latin American/Central American countries.) However, compulsory voting has a negative effect in relation to government size and transfers in Latin American countries.

The study also suggests that primary education and income have a positive relationship to voter turnout in Latin American countries. And, higher voter turnout in Latin American countries induces more government transfers, which are associated with more unequal distribution of income. By contrast, in high-income countries more participation increases government size and transfers but these in turn *reduce* income inequality.

A country's openness to international trade is a key variable in explaining the effect of voter participation on inequality. The hypothesis that exposure to international trade risks leads to an expansion in the public sector tends to be supported by the data.<sup>5</sup> However, whereas in higher income countries, openness tends to increase public sector

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<sup>5</sup> The claim is that incomes in countries with large amounts of international trade are more exposed to risks associated with trade (exchange rate fluctuations, large capital movements, etc.) and therefore the government engages in more activities to cushion incomes from these risks. Dennis C. Mueller and Thomas Stratmann, "The Economic Effects of Democratic Participation," unpublished manuscript provided by the authors, 1999.

employment, in Latin America openness is strongly correlated with an increase in education expenditures and these are skewed toward the better off in society. The logic is that a larger fraction of the public sector's education budget in Latin American countries tends to go toward university education, which largely services the upper incomes in a society. The work by De Gregorio and Lee (1999) support this argument. In their work they show that more unequal distribution of education increases the inequality of income distribution. Thus, future research on the Andean countries needs to focus on how to address inequality by looking at the relationship between education, a profile of who votes, and country openness to international trade.

*Political Parties.* With the reintroduction of democratic systems in the Andean region beginning in the 1960s and continuing into the early 1980s, political parties became once again important actors. (The exception to this has been Colombia.) An important aspect of the democratic process is the institutionalization of the political parties. In terms of institutionalization, scholars on Latin American party systems agree that Uruguay, Costa Rica, Chile and to a lesser extent Venezuela, have political parties that are more structured and less fluid than party systems in other countries.<sup>6</sup> Bolivia, Ecuador, and Peru are more toward the other end of the scale and therefore fluid. The factors that cause fluidity in a political party are: (1) voter defections; (2) a generational turnover in the electorate; (3) extension of suffrage; (4) conjunctural variations in turnout; (5) party mergers and alliances; (6) party splits; (7) election boycotts; (8) the proscription of certain parties. Colombia, along with Argentina and Mexico, are considered somewhere between institutionalization and fluidity because their political parties exhibit characteristics of institutionalization in some respects but not in others.

Bolivia, like Chile and Ecuador, has a multiparty system. In the most recent elections in Bolivia (1997), the electorate was highly fragmented with several political parties participating. It must be noted that Bolivia's plurinominal electoral system (which mixes proportional representation in Congress with direct elections) fosters a multiparty system thereby making it very difficult for one party to win a majority. General (ret.) Hugo Banzer Suárez assumed the presidency with the lowest percentage of votes (22%) ever obtained by a winning candidate. Banzer, in order to govern, formed a coalition among four parties that controlled two thirds of Congress. One party recently defected from the coalition.

In addition to weak governing coalitions, in Bolivia and Ecuador there is significant party switching during the legislative term. Weak and fragmented political parties lead to the inability to pursue long-term policies. In Ecuador a proliferation of small parties forming shifting coalitions in Congress has contributed to that institution's ineffectiveness in overcoming partisanship and reaching agreement on important national issues. The political stalemate in Ecuador's Congress in 1998 over reforms to the social

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<sup>6</sup> Scott Mainwaring and Timothy R. Scully build on the work by Giovanni Sartori in their, "Introduction: Party Systems in Latin America." In Mainwaring and Scully (eds.), Building Democratic Institutions: Party Systems In Latin America (Palo Alto, CA: Stanford University Press, 1995), 1-34. Michael Coppedge agrees with the typology created by Mainwaring and Scully in his, "The Dynamic Diversity of Latin American Party Systems." Party Politics vol. 4, no. 4 (October 1998): 547-568

security system contributed to the downgrading of the country's debt status by one rating point that year. In Ecuador as in Colombia, regional political leaders exercise significant political clout.

Colombia, Uruguay, and Venezuela have a tradition of a two-party system. However, this system is eroding in Venezuela and to a lesser extent in Colombia as partisanship and internal factionalism weakens party discipline. Associated with corruption and drug traffickers, Colombia's traditional parties—Partido Liberal and the Partido Social Conservador--lost significant ground in the 1998 national elections to independent parties.

In Venezuela, a majority of the voters elected Chávez, a former military officer, to the presidency in 1998. The two traditional parties—Acción Democrática (AD) and Comité de Organización Política Electoral Independiente (COPEI)—rife with clientilism and corruption had been losing support since 1989. Their unprecedented defeats in the 1993 and 1998 elections were directly related to the manner in which the stabilization and structural adjustment program had been managed by the government. Antagonistic relations developed between these two traditional parties and the private sector. The weakening of the two party system has been accompanied by increasing support for relatively new leftist parties, such as the Movimiento al Socialismo (MAS) and other left-of-center parties that are members of Chávez's Polo Patriótico coalition. This polarization of the party system in Venezuela toward the left could be dangerous. According to the analysis of Latin American parties by Michael Coppedge (1998), polarization with a leftist tendency has led to a higher incidence of a military coup before the next election. With Chávez and his affiliation with leftist political parties, there is potential for a right of center military coup against Chávez.

Peru's party system since 1990 is characterized as "personalistic." The traditional large parties lost to an independent candidate, Fujimori, who appealed to voters to vote for him and not an established party with a track record. However, personalistic politics is not new to Peru as it characterized the political system in that country prior to 1978. Thus, scholars tend to classify Peru as a one party system. That is, other political parties do not present significant competition to Fujimori's party, Cambio 90-Nueva Mayoría.

Multiparty coalitions are a common phenomenon in Latin American politics. The executives in Bolivia, Colombia, and Venezuela are governing with multiparty coalitions. A study by Keith Jagers and Ted Robert Gurr (1996) shows that the size of a winning coalition may be the most significant political determinant of economic growth. Governments with small winning coalitions (as in the case of Polo Patriótico) tend to have larger ratios of expenditures of revenue. An increase in the size of the winning coalition corresponds to a decrease in the ratio of government's expenditures to revenues. The argument supporting these findings goes as follows. Smaller winning coalitions require the support of opposition parties and other key actors in society in order to stay in power. In order to gain the support of others outside the coalition, favors are handed out in various forms with the end result of raising the public debt. By contrast, larger coalitions (as in the case of Banzer's coalition in Bolivia) have a more difficult time

justifying to the voters the distribution of privileges and patronage systems. Relying on privileges would quickly bankrupt the government of a large ruling coalition. Over the long term, large coalitions stay in power not because of the distribution of favors but because of policy competence.

Incentives need to be put in place that will motivate small coalition governments to avoid rent-seeking activities. Part of the incentives will be those sources of investment outside a country. Another key player in creating incentives for political leaders to cease rent-seeking activity is the export-oriented members of the private sector. And, last the military institution plays a critical role in pushing for good governance in a country by seeking to no longer waste its institutional resources and image on supporting and propping up weak and corrupt civilian leaders.

(The Legislature is treated in the discussion of the “executive” in subsection 4.)

*The Role of the Military in Politics.* The five Andean countries face serious challenges with regard to the military institution’s involvement in politics. Ecuador, Bolivia, Peru, and increasingly Venezuela are experiencing military participation in government. The involvement of the military in government and policy making directly affects the level of *democratic accountability* in a country precisely because their power escapes the checks and balances of democratic institutions. The undermining of democratic accountability is done in two ways. As seen in the case of Venezuela and Peru, the authority of democratically elected officials is subordinated to non-elected military officials who are politically appointed by the executive to government positions.<sup>7</sup> The second way in which democratic accountability is undermined is through the military removing specific areas of government authority and substantive policy making from the purview of elected officials.<sup>8</sup>

The military in Bolivia has ties to the current administration. The president of Bolivia, Banzer, is said to rely on the conservative sectors of the military institution. President Chávez of Venezuela is appointing military officers to political positions within his administration. In Ecuador, the military institution has played a behind-the-scenes role in negotiating resolutions to political crises. As long as the military is consulted on major government decisions that involve or affect the military institution, democratic accountability is not weakened. However, if the executive begins to delegate decision-making responsibility to military officers and by-pass civilian authority, democratic political institutions and procedures are undermined.

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<sup>7</sup> This type of military prerogative is called a tutelary power see J. Samuel Valenzuela, “Democratic Consolidation in Post-Transitional Settings: Notion, Process, and Facilitating Conditions,” in Scott Mainwaring, Guillermo O’Donnell and J. Samuel Valenzuela (eds.) Issues in Democratic Consolidation: The New South American Democracies in Comparative Perspective (Notre Dame:University of Notre Dame Press, 1992), 62-64.

<sup>8</sup> This second type of military prerogative is referred to as “reserved domain.” power see J. Samuel Valenzuela, “Democratic Consolidation in Post-Transitional Settings: Notion, Process, and Facilitating Conditions,” in Scott Mainwaring, Guillermo O’Donnell and J. Samuel Valenzuela (eds.) Issues in Democratic Consolidation: The New South American Democracies in Comparative Perspective (Notre Dame: University of Notre Dame Press, 1992), 64-66.

The issue for the civilian governments of the region is how to assist the military institutions in defining a modern role for itself. The involvement of members and even factions of the military institution with drug traffickers is a threat to political stability in Colombia and particularly Bolivia. In Colombia, military involvement with right wing paramilitary groups that operate independently raises serious questions about the ability of a civilian president to govern and the legitimacy of the state.

Involving the military in internal security matters, namely counter narcotics activity, also raises serious questions about the role and authority of the military in a democratic state. In Bolivia, the armed forces engage in policing of borders and border areas due to smuggling of goods and drug trafficking. In Colombia, the role of the military in counter narcotics activities is increasing with significant support and training from the United States government.

The United States and the Colombian Government also recognize the importance of strengthening the Colombian armed forces to improve their effectiveness in battle and decrease corruption within the institution so as to begin to demonstrate military might against the guerrillas. Military strategies in Colombia have been ineffective for several years designed to combat guerrillas. Currently, a military victory would not be the solution to the internal conflict. Yet, while the internal conflict persists, the possibility of successfully eradicating drug trafficking is almost nil. The solution to the internal conflict lies in opening up political opportunities for the guerrillas. Wide support exists among the Colombian population for a diplomatic resolution to the armed conflict and permitting the insurgents to participate in the political system.

#### Political Instability and Violence

This category includes several indicators that measure perceptions of the likelihood that the government in power will be destabilized or overthrown by possibly unconstitutional and/or violent means. Cross-country studies indicate that where there are high levels of political instability there will be low levels of investment (Barro, 1991; Alesina et al, 1996). However, if the rule of law variable is held constant, political instability matters less for investment and economic growth. Yet, it must be noted that political instability can reach a level where it negatively affects the management of rule of law. The level at which instability affects rule of law for the Andean countries will be a topic for further research.

Bolivia enjoys a “moderate” ranking with regard to political instability and violence. Unlike Colombia and Peru, where guerrillas and terrorists are engaged in extreme violent acts against the state and the population, Bolivia’s biggest threat to political instability is organized labor. The purpose of the labor demonstrations is to stop the implementation of economic reforms and not (as in the case of Colombia and Peru) to overthrow the government. Labor demonstrations in the 1990s have become larger and more disorderly with the Bolivian government responding with a strong show of force. Ultimately, the government has given in to organized labor’s demands. This has had negative consequences for fiscal policy and direct foreign investment particularly in the

mining industry, which accounts for more than 50% of exports. Lack of confidence in the executive to continue to implement and enforce policies and contracts undermines its credibility and, therefore, its ability to govern.

Ecuador is a democracy that has been relatively free of the political violence that afflicts its neighbors. As a result, the country enjoys a “low” ranking with regard to political instability and violence. However, recent demonstrations have turned violent. In response to organized demonstrations, President Jamil Mahuad Witt has backed down on a series of planned austerity measures. Mahuad, ruling with an opposition-controlled legislature that is against the IMF imposed austerity measures, has been unable to build consensus on key issues within Congress. The other option would be to create a broad base of popular political support. Mahuad so far has been unable to do this due to his indecisiveness in the face of strong opposition.

Bolivia and Ecuador are experiencing “spillover” effects from the insurgencies in Peru and Colombia. As guerrilla groups are forced out of those countries, they take refuge in the border areas of the neighboring countries. This, in turn, strains relations from time to time between nations in the region.<sup>9</sup> Ecuador, which is relatively drug-free, is beginning to experience more drug cartel activities on its borders with Peru and Colombia. An increase in crime and assassinations of officials has been attributed to the drug cartels. The regionalization of the drug trade will require multilateral initiatives to address it (McCaffrey, 1999).

Colombia ranks worst in terms of political instability and violence. Four guerrilla movements, active since 1948, engage in a wide range of activities among them massacres, kidnappings, extortion, robberies, and bombings.<sup>10</sup> The violence began increasing in 1995 in response to President Ernesto Samper’s peace plan and his administration’s compliance with U.S. coca eradication policies. The guerrilla movements have become autonomous moneymaking operations acquiring millions of dollars annually through their various activities. The Fuerzas Armadas Revolucionarias de Colombia (FARC), despite the Colombian government’s assertion that they are a “cartel”, does not appear to be. The FARC taxes every stage of production and engages in protection of drug traffickers but it does not participate directly in the drug trade. The FARC reportedly engages in promoting significant coca growing and cocaine production in its demilitarized zone (covering 40 percent of the national territory).<sup>11</sup>

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<sup>9</sup> For example, in 1998 Peru accused Bolivia of harboring members of the *Movimiento Revolucion Tupac Amaru*. In 1994, Venezuelan troops militarily engaged Colombian troops that had crossed the border. In 1999, three U.S. human rights activists were abducted from northern Colombia and later found murdered across the border in Venezuela. The Venezuelan government accused the Revolutionary Armed Forces of Colombia (FARC) of committing the murders.

<sup>10</sup> The four guerrilla movements are the Revolutionary Armed Forces of Colombia (FARC); National Liberation Army (ELN); Popular Liberation Army (EPL); April 19 Movement (M-19). The two groups that were demobilized in the early 1990s, the M-19 and the EPL, are now rebuilt.

<sup>11</sup> The situation is different for the paramilitary groups in Colombia. They tend to operate a significant number of laboratories and directly supply major drug traffickers, especially those from the northern Cauca Valley.

In Colombia and Bolivia coca opposition groups and organized labor have joined growers to protest the government's eradication policies. In the case of Colombia, the guerrillas are said to have instigated violent protests of thousands of coca cultivators in response to government eradication policies. In Bolivia, coca grower groups are part of the leadership of one of the main unions Central Obrera Boliviana (COB). In Bolivia, an estimated 40,000 small farmers grow coca.

Peru is ranked as "moderate" when it comes to political instability and violence. Violence has dropped significantly since 1993 after the arrest of the leadership of the guerrilla movements Sendero Luminoso and Movimiento Revolucionario Tupac Amaru. More arrests have subsequently taken place severely weakening the two guerrilla movements. However, sporadic guerrilla violence does erupt as, for example, in the 1997 taking of the Japanese Embassy by the Movimiento Revolucionario Tupac Amaru.

Whereas guerrilla violence has significantly decreased within the last seven years, civil unrest has increased in Peru. Public protests against government policies have been more frequent since 1997. The demonstrations are primarily in response to Fujimori's continued curtailment of political and civil liberties, his bid for a third term as president and, most recently, plans to privatize the energy sector.

Venezuela rates "moderate" with regard to political instability and violence. Common crime is a greater threat than is political violence. Although the Colombian guerrilla movements have been blamed for the kidnappings of wealthy businesspeople and family members in border areas of the country, no extreme political violence is taking place in the country. However, the potential for it is increasing as the movement of Colombian cocaine through Venezuela grows.

On the Kaufman, Kraay, and Zoido-Lobaton scale of aggregate governance indicators, Bolivia ranks the best in terms of political instability and violence. Venezuela, Ecuador, and Peru enjoy a moderate rating with Colombia ranking the worst for political instability and violence. Another way of explaining these indicators is by looking at who controls the geographic territory of a country. In the case of Peru, at one point during Fujimori's administration over half of that country's territory was placed under the control of military governors. By contrast, Pastrana's administration removed the military and the state from five southern districts that he ceded to the FARC's control. It is estimated that the FARC controls 40 percent of the national territory in the south and east of the country.

A clear and pressing threat to political stability for the Andean region is the spread of guerrilla violence. This violence is particularly pernicious given that the guerrillas are partners with drug traffickers and oversee drug production. Furthermore, in Colombia and Bolivia, drug traffickers have helped organize public demonstrations as a means of countering government eradication policies. In Bolivia, the demonstrations encompass a broad range of organizations including labor movements, coca cultivators and opposition groups to the government.

National structural problems exist in Colombia and Peru that obstruct constructive ways of addressing threats to undermine political institutions, leading to the deterioration in political and civil liberties. In the case of Colombia, the guerrilla warfare and the insurgents' strong ties to drug traffickers are weakening the political parties, the judiciary, and the upholding of constitutional freedoms. In Peru, the threat is the government itself, an executive who is continuing to strengthen his powers to the detriment of the other branches of government, the constitution, and civil society.

In addition, in the cases of Bolivia, Ecuador, Peru, and Venezuela, labor unrest and public demonstrations are a means of expressing dissatisfaction with economic reforms. Many citizens of these countries do not understand why the government must repay foreign creditors or pay market-based prices for fuel and utility services. Public unions and some political parties decry the selling of state enterprises to foreigners. And, many small producers of agrarian goods see free market policies as undermining their livelihood and the fabric of their rural communities. Future research will focus on how to improve dissemination of the benefits of economic reforms to the public and thereby minimize social unrest and political instability.

### **The Performance of the State in the Andean Countries**

Without political leadership and a capable political system, little can be achieved with an efficient public administration. But, without an efficient public administration, the executive, however well intended and ruling by popular mandate, may be ineffective and turn to non-democratic means of governing.

#### Government Effectiveness

This category includes indicators that measure perceptions of the quality of public service provision, the quality of the bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the credibility of the government's commitment to policies. On the Kaufmann, Kraay and Zoido-Lobaton, Peru ranks the best among the five Andean countries on government effectiveness. Colombia, Peru, Bolivia, and Venezuela rank in corresponding order after Peru from better to worst.

*Bureaucratic efficiency.* The prevailing view in economic and political theory is that bureaucratic efficiency fosters economic growth. And, economic variables may affect institutional performance. For example, an increase in bureaucratic efficiency can raise private investment that, in turn, contributes to a rise in the annual Gross Domestic Product growth rate. This, in turn, affects political stability. Thus, it is not surprising that data show a strong correlation between bureaucratic efficiency and political stability.<sup>12</sup>

The five Andean countries fare poorly when it comes to bureaucratic efficiency. Institutions lack the autonomy and expertise to continue policies without government interruptions and changes due to political pressure. Furthermore, the five Andean

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<sup>12</sup> For a discussion of the literature see, Paolo Mauro, "Corruption and Growth," The Quarterly Journal of Economics (August 1995): 681-712.

countries lack a professional civil service system. Without established procedures and institutional mechanisms for recruiting and training civil service employees, a change in government tends to translate into a high turnover in bureaucratic appointments.

Highly politicized bureaucracies increase the likelihood of corruption. Cross-country studies show that bureaucratic inefficiency is highly correlated with corruption. And, a negative association exists between these two variables and the investment rate. Thus, it can be said that governments characterized by inefficient bureaucracies will function through corrupt means thereby negatively affecting the investment rate in a country.<sup>13</sup>

*Executive.* Is the administration able to create consensus in favor of its policy reforms among key interest groups? (the private sector, political parties, labor unions). Can the executive negotiate with Congress to pass reforms that promote economic growth? The challenge for the Andean governments is to consolidate economic reforms and at the same time strengthen democratic institutions and procedures.

The administration of President Banzer in Bolivia is a multiparty coalition government. However, political expediency (implementing higher wages, postponing the capitalization of the Bolivia State Petroleum Corporation and the privatization of pension funds, failing to increase taxes) has kept Banzer from acting on necessary policy reforms. However, the executive through the formation of the National Dialogue has succeeded in creating a consensus on national issues and prioritizing them for purposes of international funding.<sup>14</sup> (Over 50 representatives of civil society and government participated in the National Dialogue. A major actor, the labor organization Central Obrera Boliviana-COB did not participate.)

President Mahuad of Ecuador is retreating from economic reforms in the face of strong opposition from labor unions, state workers, and the political parties represented in Congress. The opposition Partido Social Cristiano, which has 28 seats in Congress to Mahuad's party's 33 of the 121 congressional seats, is center-right and pro-business. The Social Christians, who initially supported Mahuad, have become his fiercest opposition in Congress opposing the IMF austerity measures Mahuad is attempting to get through Congress. A fragmented Congress will make it extremely difficult for Mahuad to form a coalition. Mahuad was successful in February 1999 in forming a temporary coalition with the Democratic Left to push through Congress a temporary deficit reduction package. However, should Mahuad succeed in forming another alliance, he will have difficulty maintaining it for any decent length of time.

For both Banzer and Mahuad, if relations with an unfriendly Congress become difficult, they might bypass Congress justifying their action on the ground that the legislature was creating a crisis (political and/or economic). This type of action has been taken in the past by Alberto Fujimori (Peru in 1992) and Jorge Serrano Elías (Guatemala in 1993). Unlike Fujimori's *auto golpe* in 1992, Venezuelan President Chávez has expanded executive powers and weakened legislative ones through the formal democratic

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<sup>13</sup> Ibid.

<sup>14</sup> World Bank, [Bolivia: Country Assistance Strategy](#) (Washington, D.C.: World Bank website).

process. The outcome of the December 15, 1999 constitutional referendum increased executive powers, extended the presidential term of office by one year (from 5 to 6 years) and permitted the president to hold successive terms. One chamber of Congress was dissolved and the military institution became more autonomous. Chávez announced the immediate suspension of the sitting Congress. The National Constituent Assembly will govern until elections can be held sometime in the first quarter of the year 2000.

Chávez, like Banzer in Bolivia, faces the political challenge of holding together his governing party's coalition. However, whereas Banzer's party coalition includes three of the major political parties in Bolivia that won a majority in Congress, Chávez's coalition is made up of smaller recently formed leftist parties that won a minority of seats in Congress. The number of parties maneuvering for power within Congress translates into political fragmentation, partisanship, legislative delay, and stalemate. Working relations with Congress often determine the success of a president's term in office and it is clear that for Banzer executive negotiating skills and compromise will be key to governing if he is to keep his coalition intact. In Venezuela the composition of Congress will change with the elections called for in the referendum of December 15, 1999.

Andrés Pastrana Arango, the president of Colombia since 1998, governs with the opposition Partido Liberal dominating the legislature as well as holding the majority of municipalities. The Partido Liberal's majority in Congress means that Pastrana has to work with them in order to avoid delay tactics, public criticism, and outright defeat of his initiatives. The Partido Liberal is itself plagued by internal disagreements on how to deal with the country's problems.

Alberto Fujimori has been president of Peru since 1990, the longest of the sitting Andean executives. Whereas Bolivia, Colombia, Ecuador, and Venezuela can be said to be types of democracies, Peru under Fujimori incrementally has become an authoritarian state. In 1992, Fujimori dissolved the democratic institutions of the country in an *auto golpe* claiming (with some credibility) that the inefficient and corrupt legislature and judiciary were impeding his efforts to modernize the economy, end corruption, fight the guerrillas, and remove the drug traffickers from the country. Enjoying high levels of popularity, Fujimori nonetheless was pressured by the Organization of American States and individual countries to restore democracy. In 1992, congressional elections took place and in 1993 a new constitution was approved that removed all legal checks on executive authority to Congress. Despite the reopening of Congress and the judicial system all key officials, including judges and Central Bank officials are appointed by the executive. Fujimori relies heavily on the military to fulfill certain government functions within the executive and for support.

To summarize, the executives in Bolivia and Ecuador are accountable to other branches of government and groups within civil society that are capable of exerting considerable influence over national decision-making. In Peru, the executive is constrained to some extent by its relations with the military institution but not in any significant manner by the other branches of government. The executives in Colombia and Venezuela enjoy independent decision-making authority, more so than in Bolivia and

Ecuador. Their accountability to civil society is constrained to some degree and certainly by the legislature and to a lesser degree by the judiciary.

If the presidents of Bolivia, Ecuador, and Colombia are to successfully implement economic reforms, they will have to improve communication with opposition political parties, raise their credibility with voters and gain the confidence of the private sector. At the same time, the governments will have to either neutralize or co-opt social actors such as unions that might raise significant opposition.

### Regulatory Burden.

This category includes indicators that measure the incidence of market unfriendly policies such as price controls or inadequate bank supervision, as well as perceptions of the burdens imposed by excessive regulation in areas such as foreign trade and business development. Bolivia has the best ranking among the five Andean countries on regulatory burden. In descending order are Peru, Ecuador, Colombia, and Venezuela.

Clear rules for contractual arrangements and mediating disputes are required in Ecuador in order to attract foreign oil producers. Ecuadorian governments have inconsistently applied laws and contracts. Delays in negotiating contracts and rampant corruption are commonplace. Cumbersome regulations exist with regard to both foreign and domestic firms that tend to inhibit investment. Bolivia and Ecuador do not have anti-trust laws that would govern competition among enterprises. In Bolivia, Colombia, and Ecuador, enforcement of intellectual property rights is weak. In Peru, the laws and regulations regarding foreign investment, have significantly improved in some areas the transparency and predictability of transactions.

### **Civil Society**

Key to governance in a society is relations among elites. Agreement among elites on procedural values, or the rules of the game, is requisite to maintaining political stability while implementing economic reforms. Consensus on the rules of the game needs to be reached within a group and across groups in civil society. Private sectors tend to be divided into agrarian, industrial, commercial, financial elites. Labor unions tend to be organized by sector: public, energy, mining, agrarian, etc. The National Competitiveness Forum in each country will be a consensus building mechanism among policy makers, the private sector, and labor organizations.

### Labor

In Bolivia, the Central Obrera Boliviana (COB) is opposed to foreign investors and privatization of the mining industry. For the most part, labor objections to reducing barriers and promoting free trade have not impeded the government's efforts to liberalize the economy. With regard to land reform and coca eradication policies, the COB has become quite active. Peasant organizations have become a principal force of organized labor as coca growers have replaced miners in the leadership of COB. This could prove difficult for the current administration that has committed itself to eradicating coca growing/cocaine trade from Bolivia by the year 2002. In order to meet this goal, the

current administration continues to rely heavily on branches of the United States armed forces and other agencies.

Labor groups in Ecuador are against austerity measures and recently have effectively opposed Mahuad's attempts to move forward on economic reforms. The Frente Unido de Trabajadores (FUT) was in the forefront of the civilian movement to oust President Bucarám and its considerable political experience could make it a formidable opponent. In early 1999, public demonstrations took place in response to unscheduled bank holidays. The protests were particularly intense in the coastal region near Guayaquil, highlighting the historic political tensions between the highland government in Quito and the coastal region. In mid-1999, transportation workers, supported by farmers, teachers, and indigenous groups, went on strike in response to new taxes on gasoline. Mahuad declared a state of emergency. State workers in the energy sector threatened to stop oil distribution and electricity if planned public spending cuts were made. The strike took place throughout the country and lasted twelve days.

In Colombia, despite organized labor's small membership, trade unions exercise considerable influence in transportation, finance, utilities, and manufacturing. In addition to four competing labor federations, local unions proliferate and are politically active. Unions provide important channels of expression for major groups of voters. Recent strikes have been organized in response to Pastrana's attempts to introduce economic austerity measures.

Peru's principal labor confederation, The Confederación General de Trabajadores del Perú (CGTP), is communist oriented. The Confederation claims to have an estimated 300,000 members, an estimated half of the unionized labor force. The second largest labor organization is the Confederación de Trabajadores de Peru (CTP) with an estimated 90,000 members. Almost one third of Peru's unions are not confederated but support the CGTP. In September 1998, hundreds of striking workers demonstrated against Fujimori's potential bid for a third term as president. They also demanded more employment. In April 1999, the unions called the first general strike in ten years against government economic policies.

In Venezuela, the Confederación de Trabajadores de Venezuela (CTV) represents approximately 25% of the 6.9 million workers, most of them in the public sector. In mid-1997, the CTV spearheaded a strike that paralyzed the country for a day to protest the inadequate increase in wages. The CTV, initially allied with the AD, began breaking away over economic policy and the privatization of state enterprises.

#### Private Sector

In Bolivia the Confederation of Private Entrepreneurs (CEPB) is the most unified of the private sector organizations. It has sought to influence government policies and in the 1989 elections, CEPB sponsored an important debate among the presidential candidates. The CEPB is independent of political parties with traditional business elites supporting Banzer's AND party and younger entrepreneurs affiliating with Sanchez de Lozada (MNR) and Paz Zamora (MIR). Some segments of the private sector are critical

of the pace of the reforms and the effectiveness of them in stimulating small to medium size firms to produce.

In Colombia, business groups have succeeded in exercising considerable influence on government policies. Relations between the private sector and government became strained under the administration of Ernesto Samper to the degree that business leaders actively and publicly called for his resignation. By contrast, the private sector actively supports President Pastrana and the president has demonstrated a willingness to consult with the private sector on legislation affecting their interests. The Asociación Nacional de Industriales (Andi), the Federación Nacional de Comerciantes (Fenalco), and the Asociación Nacional de Exportadores (Analdex) are members of the private sector umbrella organization Consejo Gremial Nacional (CGN), an influential group that traditionally has been routinely consulted on legislative drafts relating to private sector activity. The Federación Nacional de Cafeteros (Fedecafé) dominates coffee policy and other business organizations are proactive on policy matters.

In Ecuador the private sector is fragmented and although it does influence national policy, it is not united. In relation to the military, the private sector is relatively weak in influencing national policy. The business community favored Mahuad's election but was dismayed at the slow progress of economic reforms. The export sectors of the Ecuadoran economy have benefited in recent years from trade liberalization and exchange-rate stability. However, export associations are calling on Mahuad to establish a trade ministry to coordinate policies and activities among the various ministries (foreign affairs, industry, finance and agriculture).

In Peru, two of the largest private sector umbrella organizations, Sociedad Nacional de Industrias (SNI) and Confederación Nacional de Instituciones Empresariales (CONFIEP), have lobbied the Peruvian government to lower the government-imposed costs that impede investment. The Peruvian industry has suffered due to the effects of El Niño and the Asian financial crisis and seeking to improve its competitiveness.

In Venezuela, industrial interests dominate the Federación de Cámaras de Comercio y Producción (Fedecámaras). Tensions have existed between Fedecámaras and various administrations over the years. However, it must be noted that Fedecámaras, like other private sector organizations, represents large firms as well as small businesses. As a result, the organization has not been able to present a unified position on policy issues. Rather, competition among firms to influence state policies became the primary feature of private-public sector relations. A severely competitive and divided private sector was not in favor of Hugo Chávez's presidency and relations between the current executive and the business community remain tense.

In summary, relations between the private sector and the government are key to successfully implementing reforms and carrying them out. As the case of Bolivia demonstrates, macroeconomic stability alone does not spur economic growth. Institutions and regulatory frameworks are the structures that will ensure improved governance and increased economic growth beyond the short-term. Privatization, financial sector reforms,

development of capital markets, access to technology and an educated work force, the elimination of corruption, modernization of the legal framework need to be addressed so as to position the private sector, not the government, as the promoter of economic growth in a country.

### **Rule of Law**

This category includes several indicators that measure the extent to which people have confidence in and abide by the rules of society. The indicators take into account citizens' views on how well the established institutions uphold the law through implementation and adjudication. According to the Political Risk Services indicators, the five Andean countries rated poorly in terms of rule of law. By contrast, Argentina and Chile rated above average on rule of law. On the Kaufmann, Kraay, and Zoido-Lobaton scale of aggregate governance indicators, Bolivia ranked highest among the Andean countries in terms of rule of law. Peru ranked second with Venezuela third and Colombia and Ecuador tied at fourth place. By contrast, according to Political Risk Services rankings, Venezuela ranked first of the Andean countries on rule of law. Colombia remained the lowest ranked. Bolivia, Ecuador, and Peru ranked in the middle after Venezuela. It must be noted that the Andean rankings were on the lower end when compared to the high rankings of the United States, Singapore, Argentina, and Chile.

Cross-country studies show that rule of law is an important variable for investment and economic growth (Barro, 1997). A strong judicial system directly affects the economic performance of a country. Without a legal and institutional framework to guarantee the predictable, impartial, and consistent enforcement of rights, private investment remains a dubious proposition and individuals do not feel safe. Furthermore, the quality of governance in a country is directly affected by the judiciary's performance. An efficient and transparent judiciary is essential for the enforcement of laws and the assurance of accountability in other branches of government. The modernization of the judicial systems in the Andean regions has focused on the transition from a closed, written, and inquisitive system to a public, oral, and accusatory one. In addition, special attention needs to be paid to a merit-based system for appointing judges, the independent management of funds for the judiciary, and the training of judges. A strong judicial system is a cornerstone to improving governance and creating economic growth.

Bolivia, over the last two years, has made marked progress in judicial reform. In 1999, the election of seven new magistrates to the Supreme Court of Justice was widely regarded as fair and transparent. In 1998, three new institutions began functioning: The Judicial Council, The Public Ombudsman's Office, and the Constitutional Tribunal. These were designed to improve efficiency, accessibility, and accountability of the judicial process.

Ecuador's 1998 constitution called for the creation of new judicial institutions such as the National Judiciary Council that is just beginning to function. In addition, a new Criminal Procedures Code was being debated in Congress for approval. The 1995 reforms to the constitution were designed to de-politicize the judiciary and strengthen

mechanisms through which rights are enforced. The reforms included the creation of the public prosecutor's office (*fiscalia general de la nacion*) as an independent institution, the creation of the ombudsman for human rights office (*Defensor del Pueblo*), and the decentralization of the judiciary. In July 1997, Congress voted to dismiss 31 members of the Supreme Court, including its president, on the grounds that it had become too politicized. This highly irregular move followed the May 1997 referendum on the modernization of the judiciary. In October 1997, Congress selected new Supreme Court magistrates who will serve for life. In turn the Supreme Court is responsible for appointing the judges of the provincial superior courts. However, the judicial system suffers from a lack of transparency and bribery of judges are routine.

The 1991 constitution in Colombia called for modernizing and improving the efficiency of the courts. However, the court system in Colombia lacks transparency and accountability. Rather than being a public process where oral arguments are given the current system remains a closed, written process. Colombia has not adequately protected property rights. Many foreign companies rely on private security firms for protection of person and property. Police enforcement is lax; there are frequent allegations of perjury and destruction of evidence in the judicial system.

In Peru the judicial system lacks independence and transparency. The 1997 national law approved by Congress weakened the *Consejo Nacional de Magistratura's* capacity to appoint judges. The judicial system in Peru primarily consists of provisional judges appointed by executive decree and remains highly centralized. Due to the slowness and unpredictability of judicial decisions, contracts and property rights are difficult to enforce in Peru. Although the Fujimori government has sought to resolve outstanding investment and expropriation disputes with foreign companies, at the same time it cancelled an Inter-American Development Bank judicial reform project.

In July 1999, the Peruvian government voted to withdraw from the jurisdiction of the Inter-American Court of Human Rights. The IACHR had ordered the Peruvian government to retry four Chilean terrorists in a civil court. According to Apoyo, a leading research company, Fujimori's popularity has increased in part to his strong stance on terrorism that is reflected in his refusal to comply with the IACHR ruling.

The IACHR is hearing two other cases involving the government of Peru. The first case regards the appeal of Baruch Ivher; a media businessman who lost his citizenship after his television station aired criticisms of Fujimori. The more politically sensitive case is that of three constitutional judges who are appealing to be reinstated after Fujimori fired them for opposing his bid to permit the passage of law that would allow Fujimori to run for a third term as president. The international community strongly supports the reinstatement of the three judges. However, it is unclear, given Fujimori's high popularity ratings and the poor organization of his political opposition, that there will be negative consequences should Fujimori not reinstate them.

In July 1999, Venezuela's judicial reforms began with the introduction of accusatorial procedures in the criminal justice system. Jury trials and oral arguments will

be introduced as part of the final phase of the Organic Criminal Trial Code, which was introduced in March 1998.

The recent introduction of reforms to the judicial systems of the Andean countries provides a specific date from which to study the impact of the reforms on economic growth. Although there are time lags in introducing the various aspects of the reforms, these can be accounted for in the analysis.

## **Graft**

Where there is a weak and ineffective judicial system with low implementation of rule of law, there tends to be high levels of corruption. Cross-country studies show that corruption is negatively and significantly associated with rates of investment and growth. Transparency International, Political Risk Services, and the Kaufmann, Kraay, and Zoido-Lobaton scale of aggregate governance indicators rank the five Andean countries on the low end for transparency and accountability. All five countries are below the average with Ecuador and Venezuela having the worst ratings. Corruption permeates state-private sector relations. For example, in Ecuador laws exist to prohibit official corruption, but are almost entirely ignored. The country has also become the center for money laundering by the drug cartels, which is possible due to lack of transparency in financial deals. Throughout the Andean countries, corruption can be found throughout government and, as in the case of Colombia, reaching the highest levels.

### Transparency International: The Corruption Perceptions Index (On a scale of 1 to 10, with 10 being a corrupt-free society)

Bolivia	2.8
Colombia	2.2
Ecuador	2.3
Peru	4.5
Venezuela	2.3

### Kaufmann, Kraay, and Zoido-Lobaton

(Scale of about -2.5 to 2.5 with higher values corresponding to better outcomes)

Bolivia	-0.438
Colombia	-0.490
Ecuador	-0.819
Peru	-0.200
Venezuela	-0.725

### Political Risk Services

(On a scale of 0 to 6 with higher values corresponding to better outcomes)

Bolivia	3
Colombia	2
Ecuador	3
Peru	3
Venezuela	3

## Conclusions

The preponderance of democratic governance since the early 1980s leads one to ask if there is a relationship between democracy and economic growth. Cross-country studies show that the correlation between these two variables is insignificant. However, specific features of governance are important for economic growth. Cross-country studies show an association between bureaucratic efficiency, corruption, political stability and economic growth. In countries with high levels of bureaucratic efficiency, one tends to find low levels of corruption and high levels of political stability and economic growth. Thus, the data suggest that bureaucratic efficiency may be at least as important a determinant of investment and economic growth as political stability and corruption.

However, cross-country studies also suggest that rule of law may be the single most important variable for investment and economic growth. If that is the case, then the priority for future research on the Andean countries should be on rule of law, political stability, bureaucratic efficiency, and corruption. Once these variables and their relations to economic growth are better understood, specific strategies can be developed to address them.

With regard to political liberties, higher voter turnouts in Latin America tend to increase government size and promote transfers that increase rather than decrease income inequality. The data suggest that this has to do with the level of education of the workforce in Latin America as compared to those in high-income countries. Further research on this will help us better understand the relationship between political participation, education and its effect on economic growth.

Government size is also associated with the mandate of the governing coalition. An increase in the size of a government's coalition corresponds to a decrease in the ratio of government's expenditures to revenues. The larger the governing coalition the more the administration will seek to keep the public debt down. In addition, corruption tends to be less with a large governing coalition. The survival in office of a large coalition depends more on competence than on the distribution of privileges. Future research on this topic will identify mechanisms of accountability between the executive, other branches of government, and citizens.

More importantly, attention needs to be paid to key actors in society (military, private sector, labor) that are critical to the improvement of governance. Gaining the support of key elites in society for strong rule of law, bureaucratic efficiency, and the elimination of corruption, will require providing incentives for *not* doing business as usual.