

**REDISTRIBUTION, GROWTH, STRUCTURAL CHANGE
AND DOLLARIZATION:
UNDERSTANDING ECUADORIAN PERSPECTIVES**

by Marco Missaglia

Introduction

Historically, a strong dependence on primary exports, a persistent and pervasive role of the informal economy and a high degree of inequality have represented the well-known essential features of the pattern of growth and development of most Latin American economies, and Ecuador is certainly no exception. However, there are crucial differences between the continental average and the case of Ecuador and, as we will see, these differences are to be properly understood in order to say something on the evolution and prospects of the Ecuadorian economy.

Section 1 will be devoted to a broad analysis of the fundamental trends of the Ecuadorian economy over the last three decades. We will see that, despite there are no signs of structural change and the productive and trade pattern of the economy has remained unchanged, the economic and social condition of people have significantly improved especially over the last ten years. This has been possible, as explained in section 2, on account of the increasingly important role played by the State as the main contributor to growth and redistribution. This “miracle”, however, cannot be sustained over time and the deep crisis of the last couple of years is tolling the bell for us all. Section 3 is intended to show that symptoms of Dutch disease are clearly present in the Ecuadorian economy and are blocking its development within an unchanged productive pattern. Removing those obstacles is complicated and, among others, dollarization is becoming a key impediment to their removal. This is the reason why section 4 concludes with an analysis of dollarization, the

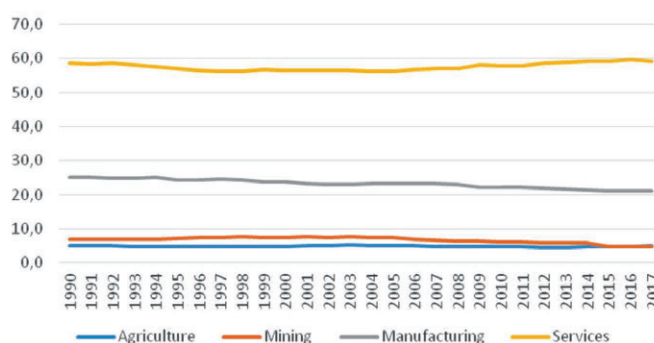
monetary regime introduced at the beginning of 2000 that certainly contributed to rescue the economy and its financial system from the great and dramatic crisis of 1998-1999. Dollarization, however, was a good medicine for that type of disease, a financial mess. Things are now different, however, and dollarization is turning into a bad medicine. As we shall see, it is now preventing Ecuadorian authorities not only from the possibility of running monetary policies, but also fiscal and pro-structural change (anti-Dutch disease) policies. The protection of already accumulated savings cannot come at the price of slowing or even blocking the formation of new, fresh savings.

1. Some key trends: redistribution and growth without structural change

In this section we will try to have a look to the fundamental, broad trends of the Ecuadorian economy compared with those of Latin America as a whole, looking at some of the main social and economic indicators. Some of these trends are well-known, others are not and it is important to take them as the starting point of our reflection on the evolution and perspectives of the Ecuadorian economy. Unless otherwise specified, we take into consideration the last 30 years, *i.e.* what has been happening after the *decada perdida* (lost decade) associated with the debt crisis of the beginning of the 80s. Data are at constant prices.

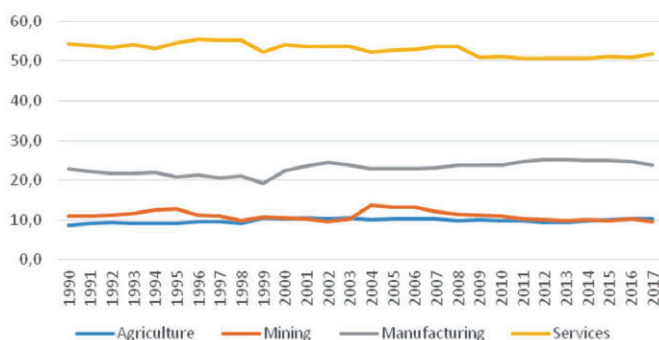
Let us first have a look at the composition of GDP by activity (Figures 1 and 2).

Figure 1 - GDP by activity, Latin America.



Source: author's calculation based on CEPALSTAT :
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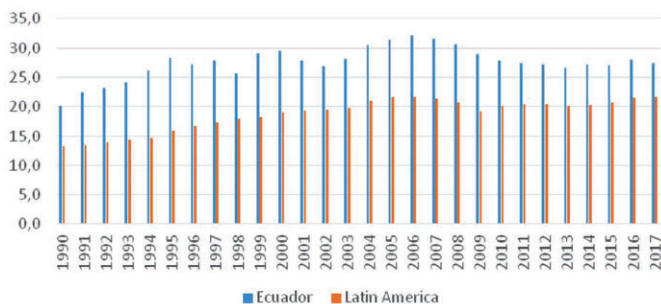
Figure 2 - GDP by activity, Ecuador.



Source: author's calculation based on CEPALSTAT :
[://estadisticas.cepal.org/cepalstat/web_cepalstat/](http://estadisticas.cepal.org/cepalstat/web_cepalstat/)

What is quite interesting to observe is the weight of agricultural and mining activities, twice as important in Ecuador as it is in the region as a whole. In the last three decades, this pattern has not changed and today these primary activities still constitute 20.1% of Ecuadorian GDP, compared to 9.8% in Latin America.

Figure 3 - Exports as % of GDP, Ecuador and Latin America.

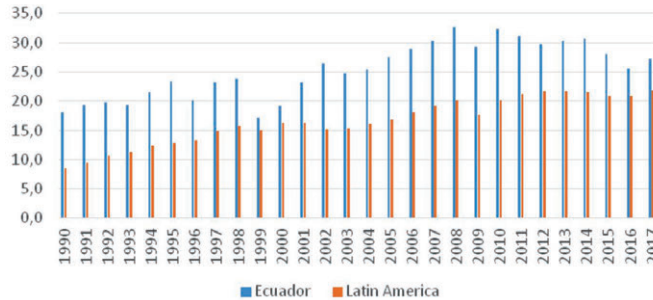


Source: author's calculation based on CEPALSTAT :
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The importance, role and pattern of foreign trade constitute another crucial difference between Ecuador and the Latin American average. Figures 3 and 4 highlight two important elements. First, as is well known, from 1990 onwards a process of progressive commercial integration with the rest of the world has characterized Latin American economies as a

whole: the participation of exports in total GDP increased over the last 30 years from 13% to 21.7% and that of imports from 8% to 21.8%. Second, Ecuador certainly participates to this general continental trend and – this is not surprising given the small size of the country – is a much more open economy compared with the regional average (foreign trade now accounts for almost 30% of GDP).

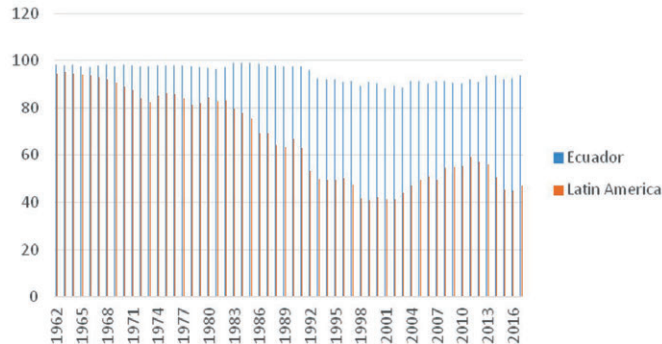
Figure 4 - Imports as % of GDP, Ecuador and Latin America.



Source: author’s calculation based on CEPALSTAT :
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Remaining in the field of foreign trade, the most striking feature of the Ecuadorian economy is illustrated in Figure 5.

Figure 5 - Primary exports as % of total exports.

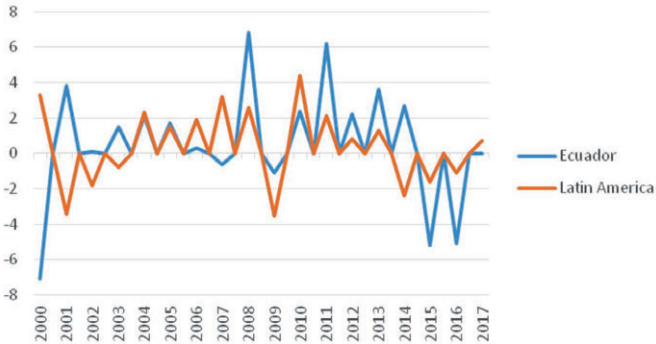


Source: author’s calculation based on CEPALSTAT :
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Both Ecuador and Latin America at the beginning of the ‘60s fully corresponded to the post-colonial stereotype of the typical “Third

World” economy, with almost the totality of their exports being constituted by primary commodities. Well, this has dramatically changed for the region – primary exports dropped from 95% to 47% of the total – but continues to be the same for Ecuador, where primary commodities still constitute the bulk of the export basket (around 93 percent). Of course, oil is the most important item¹ and, as we shall see, understanding who gets the oil rent and what this is used for is a fundamental issue. The strong dependence of Ecuador on primary exports, and in particular on oil, is revealed by other important indicators. Look for instance at the evolution of productivity growth over the last 20 years (Figure 6). It is clear that, compared to Latin America as a whole, the pattern of productivity growth in Ecuador is much more volatile – productivity increases and decreases faster as a result of its strong correlation with the vagaries of commodity and oil prices. There are two exceptions to this general trend. First, in the aftermath of the world financial mess (2009), the productivity slowdown in Ecuador was not as deep as it was in the region, for Ecuador was (and is) much less financially integrated with the rest of the world. Second, in 2014 productivity went up in Ecuador and down in the region. This is explained by the fact that the oil price reached its peak in 2014, while other commodity prices were starting to fall. Not surprisingly, things changed in 2015: the collapse in the price of oil was extremely severe and this prompted an equally severe drop in Ecuadorian productivity growth.

Figure 6 - Productivity growth.

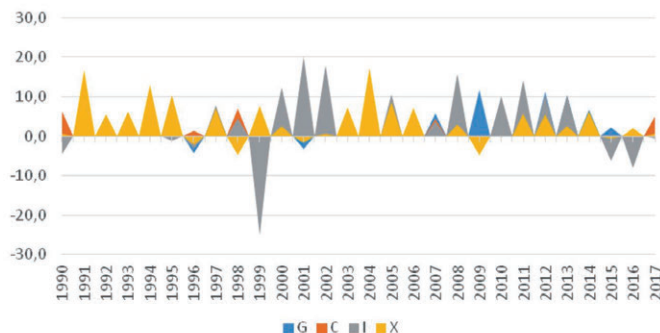


Source: author’s calculation based on CEPALSTAT :
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¹ Taking the participation of oil exports in total exports (or, which amounts to be

Looking at GDP growth from the demand side is another way of realizing how dependent Ecuador is on (primary) exports (Figure 7).

Figure 7 - GDP growth in Ecuador, demand side.



Source: author's calculation based on CEPALSTAT :
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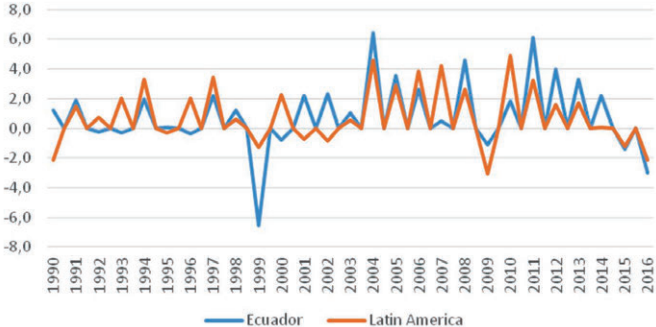
Figure 7 illustrates the contribution of the different positive components of aggregate demand (G is public spending, C private consumption, I is investment and X represents exports) to GDP growth over the last 30 years. It is quite clear how often exports (the yellow “mountain”) gave the most relevant contribution, the exception being constituted basically by the period 2009-2013. In 2009 exports gave a negative contribution, which was certainly related to the effect of the world crisis, whereas in 2010-2013 (the glory days of the Correa government) investments – in particular investments in infrastructures – turned into the most dynamic component of aggregate demand.

All in all, then, there is little doubt that in terms of its productive pattern, Ecuador can be considered “less developed” than the average Latin American economy: more reliant on primary activities in the gen-

basically the same, in primary exports) does not make much sense, however. The volatility of the world price of oil, indeed, makes this indicator extremely volatile and essentially uninformative. Just to give an example: from 2014 and 2015, the collapse of oil prices made the participation of oil exports in total primary exports drop from 52 to 36 percent (http://estadisticas.cepal.org/cepalstat/web_cepalstat).

eration of incomes, much more dependent on primary exports and therefore more exposed to the vagaries of international markets. On top of this, as we saw, Ecuador has been unable during the last three decades to reduce its dependence on primary exports, which on the contrary was an important achievement of the region as a whole. Faced with these facts, one could expect Ecuador to lag behind the rest of the region in terms of both economic dynamism and social development. Things, however, are exactly the other way round. Look first at per capita GDP growth (Figure 8).

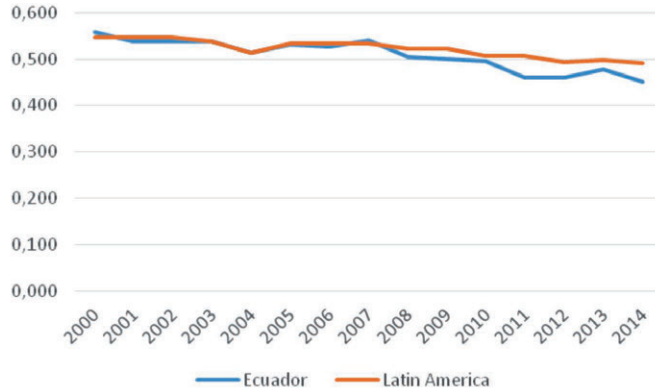
Figure 8 - Per capita GDP growth.



Source: author’s calculation based on CEPALSTAT :
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Figure 8 shows that after 2000 (do not forget that 1999 was the *annus horribilis* for Ecuador – the great crash that lead to dollarization and the migration of so many people), per capita income growth in Ecuador was systematically more rapid than the continental average. To be more precise: in the whole period 1990-2016 the average annual per capita income growth rate was 1.3% both in Ecuador and Latin America; between 2001 and 2016, however, the average Figures are 2.2% for Ecuador and 1.4% for Latin America. As to social indicators, one could look at so many Figures to describe the astonishing social development that took place in Ecuador over the last 10-15 years (basically any indicator associated with the well-known sustainable development goals). Here, however, we only concentrate on the classical indicators of inequality and poverty. First, the Gini index (Figure 9).

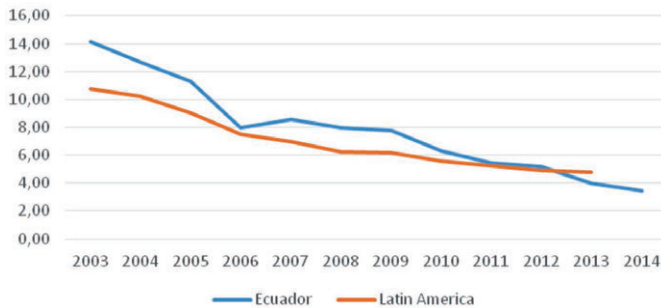
Figure 9 - Gini Index.



Source: author's calculation based on CEPALSTAT :
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Inequality declines both in Ecuador and Latin America, but it clear does so faster in the small Andean country. The same applies to poverty (Figure 10).

Figure 10 - People living with less than 3.1 dollars per day.



Source: author's calculation based on CEPALSTAT :
[://estadisticas.cepal.org/cepalstat/web_cepalstat/](http://estadisticas.cepal.org/cepalstat/web_cepalstat/)

Ponce and Vos² describe the Ecuadorian one as a case of “redistribution without structural change”. The data we just illustrated should allow us to go beyond this definition and refer, so to speak, to a case of redistribution *and growth* without structural change. Two questions naturally

² J. PONCE, R. VOS, *Redistribution Without Structural Change in Ecuador*, Working Paper No. 2012/12, United Nations University, UNU-WIDER.

arises from the foregoing. First, how was it possible for Ecuador to improve the average economic and social conditions of its people during a period where it was substantially unable to modify its productive pattern? Second: given the lack of structural change, is this good performance sustainable over time? Next sections will try to give some answers.

2. *Social democracy in the Tropics?*

Compared to previous ones, there is no doubt that the decade of the “Revolución ciudadana” (2007-2017) – *i.e.* that of the governments ruled by Rafael Correa – was characterized by the emergence of the role of the State as the fundamental engine of growth. According to the data published by the Central Bank of Ecuador³ between 2000 and 2006 the non-financial public sector⁴ spent around 20% of GDP, whereas from 2007 onward public spending increased dramatically, achieving its peak of 44% of GDP in 2013 and 2014. The composition of public spending is maybe even more interesting. In their very critical book on the government experiences of Rafael Correa, Acosta and Cajas Guijarro⁵ propose a very instructive table (see Table 1).

Table 1 - *Ecuador, the composition of public spending.*

<i>Expenditure item</i>	<i>2000-2006</i>	<i>2007-2016</i>
Salaries and wages	31.5%	27.0%
Current expenditures in goods and services	14.9%	11.9%
Other current expenditures	12.1%	23.3%
Investments, central govt.	10.8%	19.1%
Investments, public enterprises	3.4%	8.5%
Investments, local govt.	7.7%	4.7%
Other capital spending	1.6%	2.1%
Interest payments to non-residents	11.4%	2.6%
Interest payments to residents	2.8%	0.5%

Source: A. ACOSTA, J. CAJAS GUIJARRO, *Una década desperdiciada. Las sombras del correísmo*, cit., p. 61.

³ BCE; <https://www.bce.fin.ec/en/index.php/economic-information>.

⁴ Including the central government, local governments, public enterprises and social security.

⁵ A. ACOSTA, J. CAJAS GUIJARRO, *Una década desperdiciada. Las sombras del correísmo*, Centro Andino de Accion Popular, 2018.

There would be several comments to be done. Let us concentrate on some few key issue. Note that the item “other current expenditures” increased from 12 to 23 percent of the total: Correa and his governments put a lot of emphasis on social transfers, subsidies and in particular the so-called *bono de desarrollo humano*, a generalization of the first Ecuadorian cash transfer program, *i.e.* the *bono solidario*. To get a sense of the magnitudes: the average transfer per beneficiary increased from 15 USD per month in 2006 to 35 USD at the end of 2010, which is equivalent to 10 and 50 per cent of per capita income of the poorest decile in urban and rural areas respectively⁶. Public investments are the other item whose importance increased dramatically. It is important to note that both expenditure items – subsidies and public infrastructure – contributed to sustain the relatively rapid growth path of the Ecuadorian economy under the Correa regime (go back to Figure 8) through the Keynesian channel of aggregate demand but, as we saw, they did not contribute to change the productive structure of the country. Note also that the effect on aggregate demand of public investments was direct, whereas transfers and subsidies operated on aggregate demand indirectly: they improved income distribution, then increased the average propensity to spend and this way stimulated aggregate demand⁷.

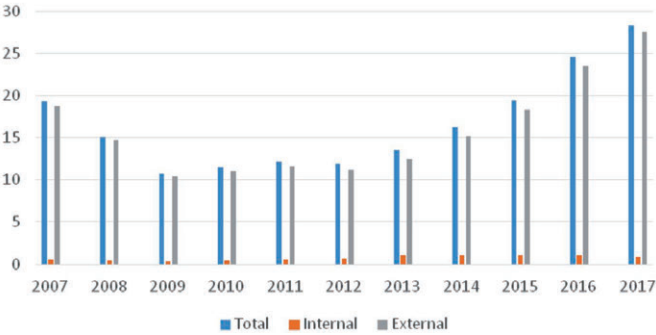
How was it possible for the Ecuadorian authorities to finance this very substantial increase in public expenditures? It is true that the oil revenue accruing to the government between 2007 and 2016 was, in real terms, the highest since 1972, *i.e.* since the beginning of the oil era in Ecuador. Just to get a sense of the magnitudes, 25% of the total real oil revenue raised between 1972 and 2016 accrued to the government in the “golden” period 2007-2013⁸, the lucky years of the great

⁶ J. PONCE, R. VOS, *Redistribution Without Structural Change in Ecuador*, cit..

⁷ During the period of the *Revolucion Ciudadana*, there was not only an improvement in personal income distribution (Figure 9), but also a moderate improvement in functional income distribution (using the data of the BCE, <https://contenido.bce.fin.ec/documentos/PublicacionesNotas/Catalogo/CuentasNacionales/Anuales/Dolares/indicecn1.htm>, one can calculate that the wage share moved from 37 to 40 percent between 2009 and 2016). To my knowledge, empirical studies showing that Ecuador is a “wage-led economy” (A. BHADURI, S. MARGLIN, *Unemployment and the real wage: The economic basis for contesting political ideologies*, in “Cambridge Journal of Economics”, December 1990, pp. 375-393) are still missing. However, this is certainly a very likely outcome. Indeed, as we saw, Ecuador almost exclusively exports primary commodities, whose prices are determined in the international markets and are unrelated to the dynamics of domestic income distribution. In other words, in Ecuador functional income distribution only affects the domestic components of aggregate demand.

bonanza. As a result, the total revenue of the public sector rose from 22% of GDP in 2006-2006 to 34% of GDP in 2007-2016, a huge increase. Yet, this was not enough to finance public spending. The already mentioned data published by the BCE show that during the period 2007-2016 the average annual growth rate of public expenditures was 17%, more rapid than the growth of total public revenues (13%). *In principle*, this gap could have been partially financed by money creation, even under a dollarized monetary regime (see section 4, whose purpose is to shed some light on dollarization and avoid some frequent misconceptions). However, that was not the case. Due to the reasons explained in section 4, dollarization acted as a very severe constraint and it was de facto impossible for the government to finance that gap between expenditures and revenues through money creation. As a consequence, government debt rose rapidly during the era of the *Revolucion Ciudadana*. More precisely, at the very beginning of that experience, from 2007 to 2009, the weight of the external debt declined because the government decided to re-purchase from the market 91% of the *Bonos Global 2012 and 2030* at a price equivalent to 35% of their face value⁹. From 2010 onward, however, the public debt-to GDP ratio systematically increased. The relevant figures are summarized in Figure 11.

Figure 11 . *Public debt, % of GDP.*



Source: author’s calculation based on CEPALSTAT :
[://estadisticas.cepal.org/cepalstat/web_cepalstat/](http://estadisticas.cepal.org/cepalstat/web_cepalstat/)

⁸ A. ACOSTA, J. CAJAS GUIJARRO, *Una década desperdiciada. Las sombras del correísmo*, cit., p. 57.

⁹ See http://www.cadtm.org/IMG/pdf/Informe_Deuda_Externa.pdf, the official report of the *Comision de Auditoria Integral del Credito Publico* delivered at the end of 2008 to President Correa.

Needless to say, what is worrying is not the absolute level of public indebtedness – 27% of GDP is very low – but the fact that this rapidly increasing debt is almost exclusively an *external* debt, denominated in a de facto foreign currency (see section 4). It might be interesting, and certainly worrying, to note that the only Latin American countries with a foreign debt-to-GDP ratio higher than Ecuador in 2016 are Honduras, Panama, Uruguay and El Salvador¹⁰. Even more interesting to stress, one fourth of foreign debt is due to China (around 7,000 million of US dollars out of around 28,000 at the end of 2017; look at the freely available report of the Ministry of Finance¹¹. Before 2007 China did not have any credit toward Ecuador – so this was certainly a choice made by Correa to avoid the conditionality typically attached to IMF and other multilateral loans. There is no free lunch, however: according to the already mentioned official report of the Ministry of Finance, Chinese loans are quite expensive compared to international standards, with an average interest rate of 7% per year. If you do not want conditions attached to the loan, the loan is more expensive (and shorter-run).

To summarize. The State was certainly the engine of growth during the last decade - a quite important “social democratic” program of social transfers and, above all, public infrastructure was financed making recourse to oil revenues and foreign loans. As a result, incomes’ growth was certainly favored, but what about structural change? Why Correa’s government was unable to “change the productive matrix”, to use one of its favorite slogan?

3. *Dutch disease and the lack of structural change*

We already saw in section 1, in very general terms, that the productive and trade structure of Ecuador has not changed over the last 30 years. Let us try now to enter into some relevant details concerning the more recent experience of the governments of the *Revolucion Ciudadana*. Few relevant numbers. First, the share of manufacture in total GDP diminished from 14.1% to 12.8% between 2008 and 2015, which is to be compared with the official government objective of increasing

¹⁰ The source is once again CEPALSTAT.

¹¹ <https://www.finanzas.gob.ec/wp-content/uploads/downloads/2018/09/AGOSTO-2018-260.pdf>.

that share up to 14.5%¹². Second, the share of non-primary exports in total non-oil exports collapsed from 44.5% to 27.8% in the same period¹³, against the governmental purpose of raising them to 50%. Third, imports of non-oil primary products also increased significantly in real terms (13% from 2010 to 2015)¹⁴, and these are commodities that are also produced domestically. These are probably symptoms of Dutch disease. Let us rapidly revise the basic economics of Dutch disease (of course there is a huge literature, an excellent synthesis may be found in Barder¹⁵). In order to benefit from a gift of foreign currency – foreign aid, a positive shock of commodity prices, etc. – some combination of the following three things must happen:

- a. shift of production from exports:
exports can be reduced while imports stay the same; this frees up productive resources (especially people) to increase production of additional non-tradables which are then consumed locally;
- b. shift of production from import substitutes:
goods and services can be imported instead of being produced locally; the consumption of these goods is unchanged but they are provided from abroad; this also frees up domestic resources for production of additional non-tradables to be consumed locally;
- c. additional imports:
additional goods and services can be imported; these additional imports add to local consumption and were not affordable without the gift of foreign currency.

The first two of these things – a shift of production from exports and from import substitutes, which are together called “tradables” – are together known as “Dutch Disease”. It is called a “disease” because domestic production of tradables has been reduced.

Well, the data we reported – in particular the reduction in non-primary exports and the increase in non-oil primary imports – might prob-

¹² See BCE, <https://www.bce.fin.ec/en/index.php/economic-information>.

¹³ See BCE, <https://www.bce.fin.ec/en/index.php/economic-information>.

¹⁴ A. ACOSTA, J. CAJAS GUIJARRO, *Una década desperdiciada. Las sombras del correísmo*, cit.

¹⁵ O. BARDER, *A Policymakers' Guide to Dutch Disease*, Working Paper Number 91, 2006, Centre for Global Development, available at https://www.cgdev.org/sites/default/files/8709_file_WP91.pdf.

ably be read as manifestations of the movements described *sub* a. and b., *i.e.* of Dutch disease. This is for instance the interpretation offered by Wong and Petreski¹⁶ in their interesting econometric study where they try to check whether and to what extent large inflows of foreign currency due to oil booms, foreign aid but also workers' remittances (a more and more important item for Ecuador after the massive migration that took place after the big crash of 1999) might have provoked Dutch disease in a bunch of Latin American economies. I would add a word of caution, for one should not forget that the Dutch disease argument summarized above needs an assumption of full employment to be fully consistent. Still, it must be admitted that this interpretation makes sense, all the more so when taking into account that over the period we are considering, the real effective exchange rate appreciated by 30% and, even today, is considered to be overvalued by around 20%¹⁷ another typical manifestation of Dutch disease.

Needless to say, the Ecuadorian authorities could not compensate this trend through some kind of devaluation, and here comes the issue of dollarization. For those who do not believe in money neutrality, neither in the short- nor in the long-run, understanding the implications of such a peculiar monetary regime is a key to rationalize the evolution of the Ecuadorian economy.

4. *Dollarization: a too straight jacket*

Almost 20 years ago, dollarization was introduced in Ecuador for the same reasons other countries in other periods decided to make recourse to hard pegs, one-to-one convertibility with the US dollars and alike: to kill inflation and inflationary expectations and restore the health of the financial system as well as an ordered functioning of the system of payments. Let me briefly summarize the reasons and events that lead to dollarization (of course, there are in the literature several much more complete accounts of the story of Ecuadorian dollarization;

¹⁶ S.A. WONG, M. PETRESKY, *Dutch Disease in Latin American countries: De-industrialization, how it happens, crisis, and the role of China*, 2014, Available at <http://mpra.ub.uni-muenchen.de/57056/> MPRA Paper No. 57056, posted 3. July 2014 05: 13 UTC.

¹⁷ WORLD BANK *Systematic Country Diagnostic Bolivia, Chile, Ecuador, Peru and Venezuela*, Country Management Unit, 2018, p. 20, available at <http://documents.worldbank.org/curated/en/835601530818848154/pdf/Ecuador-SCD-final-june-25-06292018.pdf>.

readers may refer for instance to Beckerman¹⁸ for a useful summary. In January 2000 Ecuador announced that it would dollarize fully, in response to an extremely severe crisis encompassing recession, widespread bank failures and the risk of hyperinflation. The crisis had intensified since early 1998, when a combination of external and climatic shocks hit the country.

Over the 1980s and 1990s, GDP growth had stagnated because of oil-export price volatility and natural disasters and the sacrifice of capital formation to heavy external public debt service (this is the main reason that led to the formation of the *Comision de Auditoria Integral del Credito Publico* we mentioned before – reducing that service was key to restore public investments). The exchange rate depreciation continuously needed to sustain the current account and limit external debt accumulation induced Ecuadorians to dollarize spontaneously and, for a while, a *de facto* dual-currency monetary regime prevailed. The aforementioned 1998 shocks affected real economic activity (hence bank loan portfolios) and the increasing external imbalance led to further exchange rate depreciation. In turn, the depreciation increased the local currency value of banks' dollar deposit liabilities. Many depositors, fearing that banks had become unsafe, withdrew and, due to this bank run, during 1999 the BCE had to provide banks massive liquidity support. All that led to the exchange rate collapse and incipient hyperinflation: at a point, authorities were forced to move to full dollarization.

This certainly worked - anyone knows that dollarization strongly contributed in Ecuador to restore a normal financial life. Inflationary expectations had been killed, and those lucky enough to hold a bank deposit had no more incentive to withdraw¹⁹.

In sum, there is little doubt that after a financial mess dollarization is a very effective measure. Things are very different, however, when an economy has to deal with other issues – fighting the symptoms of Dutch

¹⁸ P. BECKERMAN, *Dollarization and Semi-Dollarization in Ecuador*, World Bank Policy Research Working Paper No. 2643, 2016.

¹⁹ It is true that in the first year of dollarization inflation went up. This was, however, the once-for-all effect of the transition to the new monetary regime. To be clear, something very similar to what happened when some European countries introduced the Euro: commodities' sellers operating in a far from perfectly competitive environment took the opportunity to convert commodity prices applying an appreciated exchange rate (compared to the official one, used to convert wages). As a result, real commodity prices jumped during the transition, and only then stabilized.

disease, for instance, or put in place a countercyclical macro policy during a recession. Frenkel²⁰ and Frenkel and Rapetti²¹ argue that a competitive exchange rate is what determines the incentives for the production of a wide range of internationally marketable products, with a view to selling them in the domestic or external markets and rightly refer to the experience of the Asian tigers as revealing the need for the exchange rate to be kept weak to promote exports, especially those of nascent industries. In other words, monetary sovereignty is much more than a purely macro tool. It is a *conditio sine qua non* to deal with the perverse effect of Dutch disease and promote infant industries. Sure, it is also a fundamental macro tool, and let me clarify here some important conceptual issues (see Missaglia²², for a more complete treatment). It is now widely recognized – as a matter of fact this is part of the so-called *New Consensus* in macroeconomics – that money is endogenous and the standard way for a central bank to conduct monetary policy is through the direct control of the short-term interest rate and, hopefully, the indirect management of the whole structure of interest rates (to put it differently, central banks are quantity-takers and price-makers, and not the other way round). A first, crucial point to be realized is that *in principle* a dollarized economy is no exception. Should Ecuador, or any other dollarized country, be an economy where transactions are exclusively regulated through bank money (deposits), then the fact of being dollarized, *i.e.* unable to print a legal tender, would be completely irrelevant. This is somewhat obvious: the impossibility to print a legal tender ceases to be of any importance when people are simply not interested in using it and, instead, always accept to be paid with bank money. It follows that dollarization constitutes a limitation of sovereignty to the extent that people do not want to (or cannot, as is the case for many poor people in Ecuador who do not hold any bank account) pay or be paid with bank money and want (or have) to make recourse to coins and banknotes (the legal tender). Once this conceptual framework is clear, we have to be more explicit

²⁰ R. FRENKEL, *The competitive real exchange-rate regime, inflation and monetary policy*, CEPAL Review, No. 96 (LC/G.2396-P), 2008.

²¹ R. FRENKEL, M. RAPETTI, *Flexibilidad cambiaria y acumulación de reservas en América Latina*, Lecturas, No. 50, 2009, Buenos Aires, Iniciativa para la Transparencia Financiera (ITF).

²² M. MISSAGLIA, *Dollarization: Some Theoretical Preliminary Thought*, in “Revista Economía”, vol. 68, n. 108, 2016, Instituto Superior de Investigación y Posgrado, Facultad de Ciencias Económicas, Universidad Central del Ecuador, 2016.

about the concrete limitation of sovereignty arising from the fact of being unable to print a legal tender. Imagine that the Ecuadorian government, with the aim of running some fiscal countercyclical policy during a crisis or promoting some longer-run structural change and finance a sort of industrial policy, decides to issue some debt. In principle, it would be perfectly possible for the Ecuadorian central bank to intervene in the governmental bond market (both in the primary and secondary markets – this is not relevant here) so as to keep the interest rate at a level of its own willing. By doing so, however, and even assuming that the deposit-to-cash (legal tender) ratio of the public remains constant *but finite*, more cash *must* be available. At the end of the day, this is exactly the whole story about dollarization²³: the central bank intervention can only be sustained if new dollars (physical dollars, banknotes: the legal tender) enter into the system from the outside, and this may only happen through a balance of payments improvement (an improved trade balance and/or more remittances from abroad and/or more loans from abroad). An expansionary counter-cyclical fiscal policy, however, tends to deteriorate the trade balance, and the same applies to a pro-structural change, developmental policy that in its first phases of implementation invariably requires a surge in the imports of machineries and capital goods. If all this is clear enough, it should be easy to realize the nature of the (quite dramatic) limitation of sovereignty prompted by dollarization and understand it does not simply coincide, as generally believed, with the loss of monetary policy. It is much more than that. Going back to our example, indeed: a) if dollars are not coming in from the outside, the central bank must give up on its attempt at controlling the interest rate (at intervening in the governmental bond market), and this is a case where monetary policy is certainly lost; b) as a consequence, the government is left with two possibilities: either it gives up implementing its proposed policies (which is a loss of fiscal or, depending on the case, industrial policy) or tries to get finance (dollars) from abroad to fund them, which amounts to increasing foreign debt; or both. In short, dollarization might certainly be useful at the time of its introduction, when fighting inflation and above all inflationary expectations is the key issue. However, unless the dollarized econ-

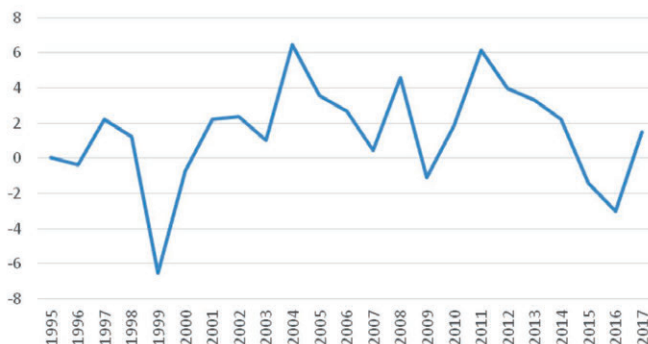
²³ Concretely, the government (whose deposit at the central bank has been credited by assumption) pays with bank money a given company in charge of, say, building a new road, but then the company must pay in cash some of its workers or, which amounts to be equivalent in terms of macro aggregates, some workers rush to withdraw some cash from their newly credited bank deposits.

omy is not part of an optimal currency area together with the United States and/or is guaranteed a special political relationship with them (which is for instance the case of Panama), it soon turns into a tremendously straight jacket, depriving the dollarized economy of a key policy tool.

In light of the foregoing, we can re-read some of the events we accounted for with deeper lens. First, and this is obvious, dollarization made it impossible for the government to counteract the tendencies toward Dutch disease. Second, when the government, operating in a dollarized regime, decided not to give up implementing its social and infrastructural policies, it *had* to fund them through mounting levels of foreign debt²⁴. Third – and this is the most recent history of Ecuadorian macroeconomics - when external loans ceased to be available at the needed rate, the government had to give up putting in place an extremely needed countercyclical policy. Let us concentrate on this third issue – this is really extremely instructive.

The recent crisis prompted by the collapse of oil prices between 2014 and 2016 and a remarkable appreciation of the dollar (vis-à-vis the depreciation of the Colombian pesos and the Peruvian “Nuevo Sol”) hit the country very tough (Figure 12).

Figure 12 - *Growth of GDP per capita, real.*



Source: WORLD BANK, <https://data.worldbank.org/indicator>

²⁴ Needless to say, it is always possible for a government to fund its spending through taxation. Here, one must admit, the governments of the *Revolucion Ciudadana* were unable to make substantial progress and the share of income tax revenue on total government revenue remained basically constant at 13%, very much the same as that prevailing during 2000-2006 (A. ACOSTA, J. CAJAS GUIJARRO, *Una década desperdiciada. Las sombras del correísmo*, cit. p. 59).

Figure 12 shows how severe the recent crisis was. In 2015-2016, for the first time after the huge mess of 1999, real per capita GDP growth became significantly negative (minus 3%). To be clear, the world crisis of 2008 had prompted a much less pronounced reduction in per capita GDP. Not surprisingly, in light of the structural features of the Ecuadorian economy we briefly analyzed in this article, the oil price and the exchange rate are much more important than the world financial conditions in shaping the evolution of the Ecuadorian economy. Well, faced with such a tough crisis, the government was unable to put in place any countercyclical policy and, well on the contrary, the World Bank informs us that “one of the most pro-cyclical fiscal policy in the region”²⁵ was implemented.

On top of the reasons so far discussed, there is a further and somewhat more fundamental element pushing in the direction of rethinking the dogma of dollarization, and this is deeply discussed in Vernengo and Bradbury²⁶. In short: regardless of what we think about the relative merits of dollarization, the fact remains that such a monetary regime is only viable, provided that the desired cash-to-deposits ratio of the public is positive, if a sufficient amount of dollars comes in from the outside. Well, if a country does not want to accumulate a mounting level of foreign debt, this condition means that the current account must be positive and this, concretely, requires a positive trade balance and/or a positive and permanent flow of remittances from abroad. Vernengo and Bradbury²⁷ show that in the case of Ecuador – due to the massive emigration of workers after the dramatic 1999 crisis (an impressive 20% of the labor force), remittances played the crucial role of making dollarization sustainable, with a positive contribution of 6.5% to current account in the dollarization period, much higher than it was before dollarization (0.6% in the 1980s and 3.5% in the 1990s). This is clearly a mode of development, a development strategy: you export your people to make dollarization viable. You export your workers to reassure your savers. How long may this last?

²⁵ WORLD BANK *Systematic Country Diagnostic Bolivia, Chile, Ecuador, Peru and Venezuela, Country Management Unit*, cit., p. 20.

²⁶ M. VERNENGO, M. BRADBURY, *The limits to dollarization in Ecuador: lessons from Argentina*, in *American Sociological Association*, Volume XVII, Number 2, 2011, pp. 447-462.

²⁷ M. VERNENGO, M. BRADBURY, *The limits to dollarization in Ecuador: lessons from Argentina*, cit..

In our opinion, then, it is time to rethink dollarization. Sure, going back to a national currency is always an extremely complex and delicate strategy, a tool which is to be manipulated with great care. However, as we tried to show, the recourse to the US dollar - very useful at the time of its introduction - is now turning into a too serious limitation, depriving the government of some key tools to design and implement its macro and development policies and making Ecuador a strange place where savers are protected at the cost of condemning workers; where the protection of already accumulated savings seems to come at the cost of making harder and harder the accumulation of new savings. Dollarization, together with some courageous policy of the governments of the *Revolucion Ciudadana*, certainly contributed to improve the material condition of many Ecuadorians; but time has come to move toward the re-appropriation of full sovereignty to make it possible the continuation of this process.

Riassunto - La sezione 1 è dedicata all'analisi delle tendenze fondamentali dell'economia ecuadoriana negli ultimi tre decenni. Nonostante non ci siano segni di cambiamento strutturale, le condizioni delle persone sono migliorate significativamente, soprattutto negli ultimi dieci anni. Ciò è stato possibile, come è spiegato nella sezione 2, per il crescente ruolo dello Stato come principale motore della crescita e della redistribuzione. Questo "miracolo", tuttavia, non può sostenersi nel tempo e la profonda crisi degli ultimi due anni lo dimostra. La sezione 3 intende dimostrare che i sintomi della "malattia olandese" sono chiaramente presenti nell'economia ecuadoriana e bloccano il suo sviluppo nel contesto di un modello produttivo invariato. Rimuovere quegli ostacoli è

difficile e la dollarizzazione sta diventando un ostacolo-chiave. La sezione 4 si conclude quindi con un'analisi della dollarizzazione, il regime monetario introdotto all'inizio del 2000, che certamente ha contribuito a salvare l'economia e il suo sistema finanziario dalla grande crisi del 1998-1999. Se la dollarizzazione era un buon rimedio per quel tipo di malattia, cioè il disastro finanziario, le cose sono ora diverse ed essa si sta trasformando in un fattore negativo: infatti sta impedendo alle autorità ecuadoriane non solo di attuare politiche monetarie, ma anche politiche di cambiamento fiscale e strutturale. La protezione dei risparmi già accumulati non può infatti essere perseguita rallentando o addirittura bloccando la formazione di nuovo risparmio.