

Ecuador: why exit dollarization?

Gonzalo J. Paredes

Abstract

Dollarization is a monetary regime that is detrimental to sustained growth and the ability to cope with successive external shocks. Setting out from this premise, the present paper sets forth five reasons why Ecuador would be well advised to end dollarization. Studies such as those of Naranjo and Naranjo (2011), Acosta (2004), Correa (2004a and 2004b), Naranjo (2004) and Jameson (2003) made valuable and distinctive contributions to this discussion, but the oil boom and the change in the mode of development over the past decade have tended to leave the debate increasingly void. This article makes reference to regulation theory and the Argentine crisis of 2001. It concludes that dollarization has been maintained because of a transformation in the mode of regulation that opened the way to a different accumulation regime, but that the country needs to restore its own currency if it is to consolidate the new mode of development.

Keywords

Dollar, monetary systems, monetary policy, economic growth, Ecuador

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I. Introduction¹

After 15 years of dollarization, Ecuador's monetary system has become untouchable. The financial and economic establishment insists that the economic stability experienced by Ecuadorian society has been due to the dollar being kept as the country's currency. However, advances in the economic sciences that have made human beings the measure of society, and the experience of one of the greatest failures of neoliberalism in Latin America, have shown how insubstantial this claim is.

In Argentina, convertibility meant that no domestic currency other than the dollar was available, and it was the essential cause of the long recession and growing debt that weighed on the Argentine economy, to the point of destroying the country's domestic production systems. This was an experience analogous to that of an Ecuador lacking its own currency.

According to Keifman (2004), the lessons of the Argentine experience are as follows: (i) rigid monetary regimes are unsustainable; (ii) while they last, all they ensure is price stability; (iii) they have high social costs; (iv) the longer they last, the higher these costs are, and (v) the distributive effects of a chaotic exit can be very great.

The idea that dollarization in Ecuador is nothing like the Argentine currency board system has been disseminated successfully in the media, politics and academia. A country experiencing its second oil boom and trying to re-establish rapid development has revived the nostrum of the Buenos Aires financial centre of the 1990s that "the regime is untouchable." This can be expected to mean an identical outcome at the end of the road. On the most orthodox economic view, dollarization is only sustainable if public spending grows at a very low (and constant) rate and the State spends no more than a fifth of gross domestic product (GDP). An excessive fixation with some policy goal, the preservation of the dollar as the country's currency being an example, often leads to this becoming an economic priority that crowds out other equally important aspects of development.

In the 2000s, enlisting favourable external conditions in the service of Ecuador's long-delayed economic development was not a matter of choice but an obligation for a social process driven by an excruciating reality. To re-establish exchange-rate and monetary policy was to strengthen this social process and the path to development. For this reason, the arguments for an exit from dollarization are manifold. As Carrera (2004) points out, only regulation theory with its multidisciplinary character can shed light on the pitfalls and collapses that threaten. Classical theory, with its conception of money as neutral, has not succeeded in explaining the Argentine crisis of 2001, and nor would it suffice to demonstrate that Ecuador's unstable economic growth in the 2000s (including the recession the country is in at the time of writing) is due to this insistence on keeping the dollar as the country's currency.

This article is structured as follows: following the Introduction, section II analyses the political economy of the loss of monetary sovereignty, while section III discusses five reasons to abandon dollarization in Ecuador. Lastly, section IV offers a number of conclusions and closing reflections.

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II. The political economy of the loss of monetary sovereignty

In the late twentieth century, Ecuador suffered one of the deepest crises in its history, a bank failure stemming from application of the General Law of Financial System Institutions, which was actuated by two types of rivalry, one geographical, the other a struggle for monopoly power in the banking sector and beyond.

The law was presented as one that would restructure the banking business as a whole, but it ended up creating the conditions for a purge within the sector. By liberalizing banking, handicapping the Superintendency of Banks in its oversight work, formalizing financial groups and permitting linked credit of up to 60% of the technical equity of lenders, it helped make the whole financial system more susceptible to corruption (Falconí and Oleas, 2004; Miño, 2008).

Banks that did not resort to harmful practices and that at the same time strove to capture a larger market share, being classified as medium-sized, were “rewarded” with the power not only to form a deposit and investment oligopoly but also to control monetary liquidity via the loss of monetary sovereignty.²

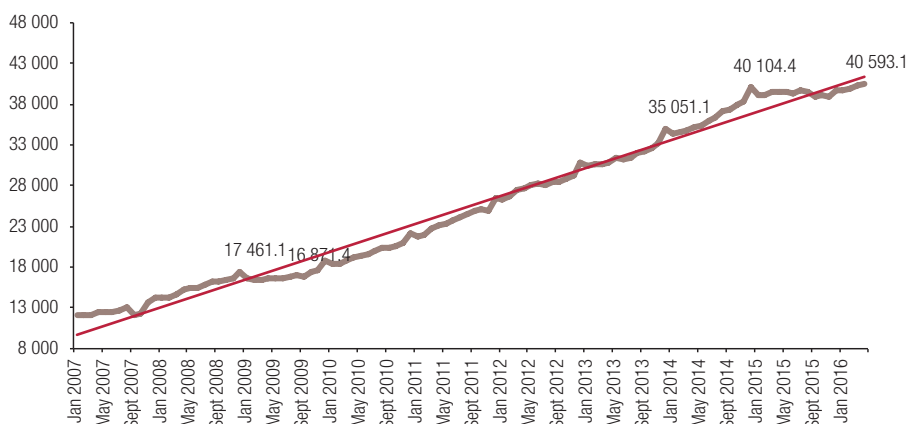
On the way to this rationalization in the sector, one of the main characteristics of the system established during the rise of neoliberalism in Ecuador was abolished: the independence of the Central Bank of Ecuador. This independence was enshrined in the country’s 1998 constitution and subsequently in the Organic Law on the Monetary Regime and State Bank. However, temporary provision no. 42 of the same constitution established that the central bank could “provide credits to financial institutions to secure stability and solvency, and credits to secure the preference right of natural persons holding deposits at institutions going into liquidation.” In this way, moral hazard was enshrined in the constitution and central bank independence destroyed (Oleas, 2001).

Stiglitz (2012) asks how it is possible for financial sectors to get so much wealth and answers that part of the answer is simple: they helped write a set of rules that allows them to do well, even in the crises that they have helped create. This reflects the purpose of the General Law of Financial System Institutions. This law, which allowed the sector to conduct an internal purge, moved the country’s financial and geographic hub from Guayaquil to Quito. Financial institutions classified as medium-sized and small came to dominate the banking business and, with dollarization, the so-called monetary liquidity of the economy as well (see figure 1).³

² According to figures from the Superintendency of Banks, the banks classed as large as of December 1993 were Filanbanco and Banco del Pacífico, with 13.81% and 13.21% of total assets, respectively. The medium-sized banks were Banco Pichincha, Banco del Progreso and Banco Guayaquil, with 10.2%, 7.62% and 5.34%, respectively. The small banks were La Previsora and Produbanco. By December 1998, Banco del Pacífico had lost ground in the sector to Banco del Progreso, which less than three months later would be mired in corruption problems.

³ In his opinion column of 11 August 2013 in *El Universo* newspaper, Walter Spurrier wrote: “The effects of the banking crisis can be seen in the production figures. In the late twentieth century, Guayaquil was the undisputed financial capital. Now, one of the biggest gaps between the two is that financial value added in Quito is 46.2%, more than twice that of Guayaquil, where it is 21.2%” (Spurrier, 2013). See [online] <http://www.eluniverso.com/opinion/2013/08/11/nota/1269991/economias-guayaquil-quito>. It should be enough to point out that Banco Pichincha had 10.86% of total assets in December 1998 and 27% in December 2002, at which time Produbanco had 10.81% of total system assets, whereas in December 1998 it was a small bank with 3.84% of assets.

Figure 1
Ecuador: total liquidity, January 2007 to April 2016^a
(Millions of dollars)



Source: Prepared by the author, on the basis of Central Bank of Ecuador, *Información Estadística Mensual*, No. 1971, Quito, 2016.

^a Total liquidity or broad money includes the money supply and near money.

The monetary base, which before January 2000 originated from and was managed by the Central Bank of Ecuador as issuer, now comes from the external sector and is administered by the banking sector in its role as intermediary. Furthermore, the fact that there is no central bank with the ability to run monetary, credit and financial policy has left the private-sector banking system wholly in charge of creating bank money.

The 1999 banking crisis and the loss of monetary sovereignty opened the way to a new stage in the thinking dominant in Ecuador during the 1990s, namely the new neoliberal dispensation, which did everything possible to convince people of the virtues of dollarization and the risks that abandoning it would involve. It also fostered conditions that could not be bettered for the banking business, characterized by a rising oil price, increasing migrant remittance flows, a State that had a large social debt and was administratively and fiscally disorganized to the highest degree, and self-regulation.

The 1999 crisis forced a number of reforms to be made to banking supervision. Nonetheless, the sector retained intact its ability to fix the prices of lending and deposit operations and of financial services, to create its own “liquidity fund” in banks abroad, to decide the orientation and allocation of credit and, particularly, to continue transferring currency freely in and out of the country. In this exceptional situation, throughout the dollarization period, banks have made large profits that have turned this into one of the most profitable and prosperous sectors in the Ecuadorian economy.

III. Five reasons to abandon dollarization in Ecuador

1. The background to currency policy in Ecuador

In both its course and its outcome, the Argentine crisis of 2001 was an experience analogous to that of an Ecuador lacking monetary sovereignty.⁴ The currency board system and dollarization belong to

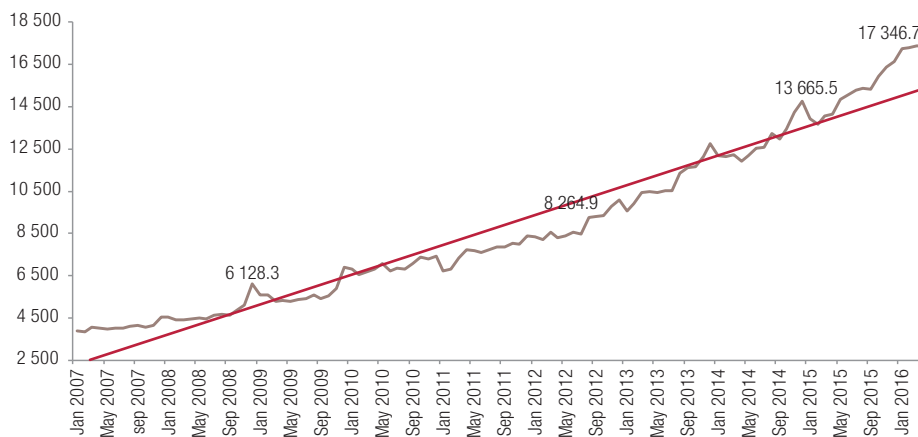
⁴ A few weeks after the currency board system was abandoned in Argentina, warnings were ignited in debates and forums in Ecuador. In February 2002, issue no. 92 of *Gestión* magazine, which specializes in social and economic issues, gave central place to the question of whether dollarization was a time bomb.

a type of passive monetary integration in which a country adopts the currency of another country or a monetary area and relinquishes the power to take decisions about monetary, credit and exchange-rate policy (Cuevas, 2002; Paredes, 2015).⁵ When this happens, the factors determining the quantity of money are endogenous and the monetary constraint becomes much harder to deal with.

In Ecuador, the quantity of money depends on foreign trade. In Argentina, it was subordinated to capital flows, given the international context in which the plan arose. Thus, when foreign capital began to disappear in 1998, the monetary base started a process of contraction that was transmitted to the lending system and, some time later, to the whole payments system.

The effects of the international financial crisis of 2008-2009, transmitted to Ecuador through trade, also caused the monetary base to shrink (by US\$ 844 million between December 2008 and May 2009). This led to a deterioration in the labour market and halted the progress made with income distribution, poverty and indigence in the previous 24 months (see figure 2) (Paredes, 2015).⁶

Figure 2
Ecuador: monetary base, January 2007 to April 2016^a
(Millions of dollars)



Source: Prepared by the authors, on the basis of Central Bank of Ecuador, *Información Estadística Mensual*, No. 1971, Quito, 2016.

^a The monetary base or high-powered money is defined for accounting purposes as the sum of currency in circulation and bank reserves. In the dollarization system, what are considered are currency in circulation, banking system cash holdings (Central Bank of Ecuador and other deposit corporations) and banking reserves held at the Central Bank of Ecuador.

The currency board system in Argentina was based on four pillars: (i) the promise that there would be no intervention by any collective authority; (ii) one-to-one parity, which would serve to ensure the stability of the system of accounts and the proper functioning of payments; (iii) arguments from legitimacy, such as the fact that the central bank would lose the ability to manage the amount of money in the economy at will, and (iv) the idea that no alternative monetary regime could be constructed.⁷

⁵ Martirena-Mantel (2003, p. 97) argues that dollarization in Ecuador, categorized as unilateral (even though it also implies a single currency), does not necessarily meet Robert Mundell's criteria for an optimal currency area.

⁶ The labour market is a strategic space for dealing with economic inequity and inequality (Sánchez, 2011). It is there too that external shocks are concentrated, reproduced and amplified, particularly in the case of a labour market like Ecuador's with a very high rate of underemployment. According to Fuentes (2014) and ECLAC (2012c), structural heterogeneity is associated with a high degree of labour market segmentation.

⁷ Regulation theory identifies these pillars as forms of "trust." Aglietta and Orléan, cited by Marques-Pereira (2007), argue that political sovereignty is maintained in monetary matters provided the three dimensions of trust obtain, these being the methodical, hierarchical and ethical dimensions. The first is manifested in the proper functioning of payments and the second in the guarantee of an authority, while the third is defined by criteria of legitimacy. Roig (2007) adds one more: desperate trust, which has two effects: (i) it makes the monetary institution less flexible, preventing it from incorporating change and being transformed because any alteration of the monetary form jeopardizes trust in it, and (ii) it deactivates politics, i.e., prevents it from exercising any type of action on the economy, and thence transforms the configuration of political responsibility.

In this context, the inability of the State to find effective instruments to keep the economy operating at full capacity, the false promises of one-to-one parity, the notion that inflation was a purely monetary phenomenon and the political strength that enabled the financial and economic ruling class to impose its ideas led Argentina, South America's second-largest economy, into a deep recession that caused severe intergenerational social harm.

Economic growth and income recovery between 1990 and 1994 were inequitable, with the real income of the top decile higher than it was in 1980. Developments subsequent to 1994 were clearly regressive. The incomes of the lowest-income 60% of households declined and those of the top three deciles improved. In other words, the distributive situation at the end of the twentieth century represented a substantial regression in real terms from that of 1980 (Altimir, Beccaria and González, 2002).

According to the Permanent Household Survey (EPH) of the National Institute of Statistics and Censuses (INDEC) of Argentina, 26.2% of households in 28 conurbations were below the poverty line in May 2001. A year later, in May 2002, the figure had risen to 41.4%, showing the profound effects caused in this period by the severe adjustments in the economic policy run by the then minister Cavallo and his team of advisors to maintain parity with the dollar. In Greater Buenos Aires, the incidence of household poverty was 23.5% during the period stated. A year later it was 37.7%. If the largest cities are included, the number of households affected by poverty was greater, showing that income distribution clearly regressed much more sharply in the provinces. Social conditions reflected the behaviour of the labour market, the deterioration of public goods such as health care and education, and the disruption of the production and social fabric, mainly in the large urban centres.⁸

For this reason, Carrera (2004) claims that convertibility brought a radical transformation in the behaviour of the labour market: the old pattern of the 1980s, with unemployment rates holding fairly steady while real wages fluctuated greatly, was replaced in the 1990s by one with exactly the opposite characteristics. In the same way, convertibility produced highly disparate results: an exceptional performance for growth and inflation, but poor performances for the external sector, the labour market and income distribution.

Given all this, the question must be why economic agents are so convinced that convertibility is viable in the long run. Three reasons have been given. In the first place, Boyer (2007) writes that the model gained traction in a consistent institutional and ideological framework that, according to Wainer (2010), formed part of the interlinkages between the different bourgeois factions under the hegemony of financial capital.

In the second place, Galiani, Heymann and Tomassi (2003), Heymann (2000) and Conesa (1996) propose a hypothesis of the expected effects of "contractual density." Strict adherence to the existing monetary rule (via an elaborate system of contracts, most of them denominated in dollars) was identified with stability and predictability. To this end, the government (by issuing dollar-denominated bonds) and the private sector (by building up large dollar debts and assets) ensured that their solvency would depend on the exchange rate being maintained. The set of promises seemed to be such that they had to be either all kept together or all broken together. Any departure from the status quo of one peso for one dollar would create a shock with unpredictable consequences.

Thirdly and lastly, Roig (2007) developed a hypothesis for the way the production of knowledge, and particularly economic knowledge, affected the functioning of convertibility and the crisis in it,⁹

⁸ Ferrer (2004) defines this situation as one of "structural heterogeneity" and uses the concept of "national density."

⁹ Roig (2007) writes that logics of authorization can be found in all professions and disciplines, but take on a particular dimension in the economic sciences. Of all the sciences close to "power," this is the one that is most respected, has a truth status that validates authorization, and is most widely disseminated in society through education and the media.

making it possible to construct a specific form of trust dubbed “desperate” around the currency, based on the impossibility of exiting the established monetary regime. The author argues that this impossibility stemmed not only from the assertion that it was so, but mainly from the discrediting of the possibility that there might be alternatives.

The three reasons for viability given are not mutually divergent but quite the opposite. The sense of impossibility was underpinned by the “fear of floating” that resulted from the elaborate contractual form of convertibility and the institutional and ideological consistency so widely proclaimed by the media and academia. Convergence was possible because the monetary regime created increased scope for rent-seeking.

2. The strict monetary constraint is highly vulnerable to persistent external shocks

Money operates as a medium in relationships of exchange where it is used for this purpose. This is what is known as the monetary constraint. From this idea it follows that commodity realization is subject to the availability of money in the economy (Aglietta, 1979).

The dependence of capitalism on commodity circulation is expressed by equivalence relationships in exchange. The monetary constraint is not a permanent and absolute yardstick, but depends on how the general equivalent is formed. Banks experience the monetary constraint relative to society as a whole because they are required to convert the different bank moneys into commodity money on demand and without any limitation whatever. This general and permanent conversion is the proof that bank money has the attributes of its general equivalent.

For Aglietta (1979), any crisis in the realization of exchange value takes on a global character and presents as a financial crisis. This concerns all types of financial circulation, but the epicentre of the crisis is necessarily the banking system, which is where private debts are mobilized. Thus, the role of the central bank is to organize the bank money convertibility process by manipulating the issuance of its own money.

The implementation of the currency board system coincided with an upsurge of capital flows into emerging countries. These flows were the main underpinning of this regime in the early years and went mainly to the financial system, the result being quite intensive processes of bank money creation that systematically outpaced the money supply. When these flows went into reverse, two adjustment mechanisms came into action: one was automatic (contraction of the monetary base) and the other was applied when the first failed to work (fiscal adjustment).

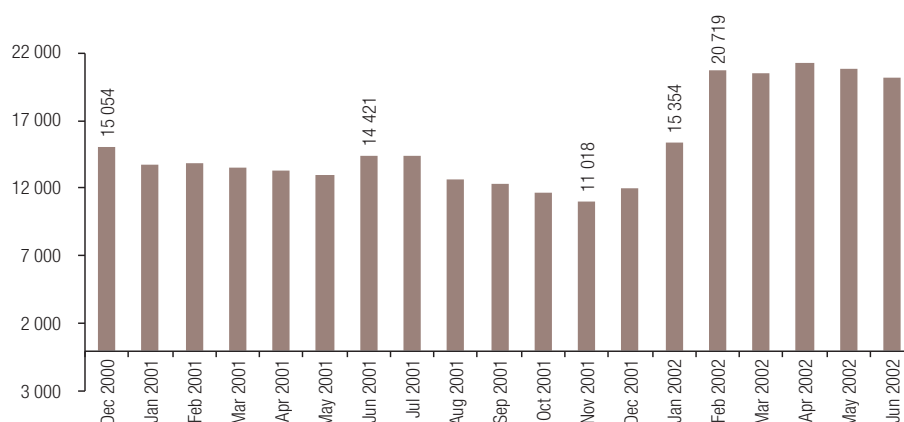
However, when capital flows were not positive (they turned negative because of capital flight) and loans could not be obtained from international organizations (the International Monetary Fund suspended support to Argentina, instituting the Krueger-Rogoff approach of non-intervention in financial crises to avoid moral hazard), higher interest rates were not enough to incentivize international investors. It was then that fiscal adjustment was brought into action in an effort to remedy the absence of external capital by means of a greater economic contraction that would lead to higher interest rates (to encourage capital to return) and lower labour costs so that tradable goods could be produced more cheaply.

The “adjustment to the adjustment” carried out during the government of President De la Rúa did not succeed in incentivizing the return of capital flows, since the economic imbalances created by the currency board were becoming increasingly evident. The idea of generating a fiscal surplus to service the external debt by way of ever-larger cuts to current spending simply did not work (IMF, 2004, p. 43 and 2001, pp. 29 to 33).

The shortage of money entailed by the tension over currency reserves led to an explosive proliferation of the multiple units of account resulting from the social and fiscal effects of the Convertibility Act (social currencies and provincial bonds circulating as cash). Baldi-Delatte (2007) defines this situation as a monetary crisis in which the lack of unanimity about the use of one or a number of mutually convertible currencies is manifested by instability in the monetary system, which in turn leads to an economic crisis.¹⁰

Figure 3 shows monetary scarcity (reduction of the monetary base), which worsened in the second half of 2001, with the monetary base shrinking to 11.018 billion pesos in November from over 15 billion pesos in late 2000. It is important to note that the quantity of money (monetary base) in circulation at the end of the first boom of the convertibility period (December 1994) was 16.049 billion pesos, whereas by the end of the second boom (December 1998) it was 16.37 billion pesos. In other words, almost a third of the monetary base had been lost before convertibility ended.

Figure 3
Argentina: monetary base, December 2000 to June 2002
(Millions of pesos)



Source: Prepared by the author, on the basis of figures from the Central Bank of Argentina.

As mentioned earlier, the monetary base of Ecuador also shrank for a period during dollarization, by US\$ 844.1 million.¹¹ Matters became pressing between December 2008 and May 2009, when there was a decline of some 14%. By contrast with the Argentine case, the monetary base did not carry on shrinking but recovered in the months that followed and returned to its December 2008 level a year later, as figure 2 shows.

This difference was due to the rising trend in the oil price in the second half of 2009, but mainly to the fact that public policies were used to create degrees of monetary policy in respect of dollarization. The fundamentals of an economy without a currency of its own mainly turn on the fact that the central government no longer has the ability to print money, although in a State that was organized to fulfil its oversight and regulation role it would have the ability to dispose of private savings in foreign banks (under the administration of private-sector financial institutions located in the country) and place these at the service of the urgent financing needs of the country's economic agents.

In September 2009, the Government of Ecuador created degrees of monetary policy when, by virtue of a resolution of the Central Bank of Ecuador, it obliged private-sector banks to repatriate depositors' savings held in foreign banks to boost credit in the country. It thus avoided a worsening

¹⁰ What is meant by a monetary system is the set of rules that make it possible to set prices, conduct transactions and define the obligations involved in honouring them.

¹¹ This by no means had the characteristics of a temporary or one-off fluctuation.

of the phenomenon defined by Aglietta (1979) as monetary constraint, since public policies and the international situation, in that order, did not allow it.

However, if a policy of permanent fiscal austerity had been maintained in Ecuador, like the one designed in the early years of dollarization, combined with an over-cautious bank deposit guarantee policy, the monetary base would have been greatly reduced and production and commercial activities would thus not have developed to their fullest extent. If the realization of commodities is subject to the availability of money in the economy (monetary constraint), a worsening of the constraint means a crisis of realization, which did not happen in Ecuador because of the creation of degrees of monetary policy in respect of the monetary regime. This was a very different situation from the one in Argentina, a country that, as the crisis deepened, opted to commit itself even further to the convertibility system.

3. The new mode of regulation or the monetary regime?

Regulation theory proposes a multidisciplinary approach to understanding capitalism and its crises. This understanding makes it possible to establish “intermediate” concepts to explain the way capitalist economies develop, namely the mode of regulation and the accumulation regime. The former channels individual and collective behaviours in a way determined by the accumulation regime, which enables institutional forms to be reproduced.¹²

Boyer and Saillard (1998) conceptualize the accumulation regime as a set of regularities that ensure general and fairly consistent progress in capital accumulation, i.e., that allow the distortions and imbalances continually arising out of the process itself to be reabsorbed or deferred.

The specific way in which a capital accumulation regime is linked to a mode of regulation within each social formation leads to the constitution of a mode of development. Modes of development can be quite diverse depending on national specificities and the way different accumulation regimes and modes of regulation are able to exist and follow on from each other. Consequently, crises in the mode of development are the result of modifications arising at the levels of the accumulation regime and the mode of regulation.

From the point of view of regulation theory, the transition from one mode of regulation to another can take place because of a transformation in institutional forms, or the emergence of crises at this level. It often leads to a change in economic mechanisms and regularities. The nature and scale of these crises are very heterogeneous, as they depend on the economic structures characterizing each social formation. The specific new institutional forms do not arise mechanically or necessarily, nor must they be predetermined by the accumulation regime. Their emergence and the consolidation of their configuration can take some time, with the final outcome revealing the correlation of forces and the strategies and goals of the social actors involved.

On this theory, it can be said that economic stability in Ecuador has been due neither to the monetary regime called dollarization nor to the dollar.¹³ Stability originated rather in the formation of a new mode of regulation (as occurred in the post-convertibility stage) that has given rise to a different mode of development.

The purpose of describing institutional forms and transformations in them is to show that the economic growth of the past decade would not have been possible without the dismantling of the

¹² There are five institutional forms for a mode of regulation: (i) the currency (or monetary constraint); (ii) the State; (iii) wage labour; (iv) forms of competition, and (v) participation in the international economy.

¹³ In a column published by the Cato Institute and *El Universo* newspaper with the title “Dolarización: ser y parecer”, Gabriela Calderón argues: “Dollarization does not keep going, as the press claims every day, because of reserves, high oil revenues or migrant remittances. It keeps going because Ecuadorians wish to carry out their transactions in that currency, while those administering the State need to adopt strict fiscal discipline and policies that encourage local and foreign investment” (Calderón, 2009).

whole structure designed in the new neoliberal dispensation. When the State is radically transformed, there are chain reactions that also affect all other institutional forms.¹⁴

The international financial crisis that broke out in September 2008, the constraints on fiscal policy and the total absence of monetary policy would have taken the economy deep into recession. According to this premise, the mode of regulation is in a transitional stage that should culminate when dollarization is abandoned. The transition in the mode of regulation is expressed in the changes to institutional forms described in table 1.

Table 1
Ecuador: changes in institutional forms, 2000-2006 and 2007-2015

	2000-2006	2007-2015
Currency	<p>Unrestricted circulation of international currencies in the country and transfer abroad, on the basis of the Economic Transformation of Ecuador Act of 13 March 2000 (the statute that gave effect to dollarization).</p> <p>No lender of last resort.</p> <p>Savings administered by the Central Bank of Ecuador and the private-sector financial system were deposited in foreign banks or invested in paper. Saving in the economy as a whole served to support the development not of Ecuador but of foreign countries, and to increase profits.</p>	<p>Public policies sought to maximize currency repatriation, minimize outflows and strengthen domestic saving and investment.</p> <p>A financial security network designed not to affect moral hazard in banking activities was created in 2008.</p> <p>The notion that there was no monetary policy under dollarization was shown to be an ideologically driven falsehood.</p> <p>The system of State institutions overseeing financial activities was strengthened with the creation of the Monetary and Financial Policy and Regulation Board, with 54 functions.</p>
State transformation	<p>The reduction of the State's role in the economy began simultaneously with the debt crisis, which worsened in the 1990s, and continued when the banking system failed. For years, the Ecuadorian State gave less priority to the social sector than to external debt servicing and acting as "guarantor" of 100% of bank deposits.</p> <p>From 2000, the State was subjected to innumerable fiscal constraints based on the experience of Argentina and Chile. The greatest austerity during dollarization was implemented between 2003 and 2005 under the decree of 22 January 2003 and the letter of intent (special drawing right agreement) signed by the government on 10 February 2003 in Washington, D.C. (see [online] http://www.imf.org/external/np/loi/2003/ecu/01/index.htm).</p> <p>Contingency funds, created under various statutes, ensured external debt would be paid.</p> <p>The State's share and presence in the economy diminished (20.42% of GDP in 2004, the lowest point in the dollarization period).</p>	<p>Bureaucratic reorganization and reinstitutionalization.</p> <p>Default and renegotiation of commercial debt in December 2008.</p> <p>The transformation of the State, undertaken in 2007, removed the foundations that dollarization had been built on (chain reactions).</p> <p>A larger State share and presence in the economy (44.04% of GDP in 2013).</p> <p>Recovery of sovereignty over economic policy.</p> <p>After the oil funds were abolished in February 2008 by the Constituent Assembly, in October 2010 the National Assembly passed the Organic Code of Planning and Public Finance that repealed laws from the neoliberal era: the Organic Law on Financial Administration and Oversight, the Organic Law on Fiscal Responsibility, Stabilization and Transparency, the Organic Law for the Recovery of the Use of State Oil Resources and Administrative Rationalization of Borrowing, the Public-Sector Budget Act and chapter I of the Economic Regulation and Control of Public Spending Act.</p> <p>The only fiscal rule that currently exists in Ecuador is that permanent expenditure should not exceed permanent revenue.</p> <p>In 2015, a tariff structure was designed to preserve the quantity of money in the economy in the event of external shocks such as dollar appreciation or a fall in the oil price. In 2016, furthermore, the institutional arrangements for reducing fiscal avoidance were strengthened, especially for the tax on bequests, legacies and donations.</p>
Wage labour	<p>The Economic Transformation Act established the hourly employment format, which could be applied to up to 75% of a firm's workers.</p> <p>The disappearance of the State in all areas of society was most strongly felt in the labour market, where the regulatory agencies lost all ability to act to protect workers from the employer class.</p> <p>This made insecure and informal employment the rule rather than the exception.</p>	<p>Hourly employment and the rise of outsourcing and labour intermediation (without any regulatory framework until May 2006), with increasingly insecure and informal working conditions, were inconsistent with international employment conventions and prevented unionization and collective hiring. This situation was addressed by the Constituent Assembly of 2008 in Constituent Mandate no. 8, comprising seven articles, four general provisions, five temporary provisions and three final provisions, in which these two statutes in particular were repealed.</p> <p>The new way of conceiving work involved the creation of decent, fair conditions for workers. To this end, the State acts via regulations and actions that create the basis for different forms of work. The concept of a decent wage was established and work in the home recognized.</p> <p>The restoration of the State and sovereignty over economic policy have changed the correlation of forces between workers and employers. Nonetheless, emphasis has been placed since 2015 not only on the inequalities in the capital-labour relationship, but also on the working class. Accordingly, a ceiling has been placed on profits distributed to workers, which can usually not exceed 24 times the unified basic wage.</p>

¹⁴ Regulation theory is underpinned by the idea that institutions represent social commitments that can be treated as sociopolitical commitments. Behind every institution is a conflict seeking resolution. Institutions determine a certain relationship of forces and establish a hierarchy, with all the consequences this has for the distribution of income and power, among other things. The role of public action, of the State, may consist in favouring or otherwise the emergence of certain commitments. See Amable (2007) for a more in-depth study of institutional complementarity.

Table 1 (concluded)

International	<p>Dependence of the fiscal and external sector on one State asset, oil. In 2004, this accounted for 30.08% of total central government revenue and 54.61% of total exports.</p> <p>The trade channel prevailed over the financial channel. Changes in tradable goods prices influenced the fiscal sector and the external sector more than international interest rates did.</p> <p>Import growth averaged 21.20% during the period.</p> <p>Fuel imports rose from US\$ 243.84 million to US\$ 2.54 billion.</p>	<p>In 2013, oil accounted for 22.93% of total central government revenue and 56.78% of total exports. At the end of 2015, the figures were 11.13% and 36.33%, respectively. A trade agreement with the European Union may be in prospect, given that Colombia and Peru have free trade treaties with that regional bloc and with the United States.</p> <p>Inward foreign direct investment (FDI) has been very low by the standards of the region (ECLAC, 2012b). Inflows of FDI in strategic sectors have been identified since 2014.</p> <p>Import growth averaged 12.31% up to 2013. The effects of the tariff structure mentioned earlier were reflected in a 22.64% fall in imports between 2014 and 2015. Between January and April 2016, the reduction was 36.46% on the same period the year before.</p> <p>Fuel imports rose from US\$ 2.54 billion to US\$ 6.62 billion. In 2015, these imports totalled US\$ 4.17 billion.</p>
Form of competition	<p>There was an “incestuous relationship” between the banks, the media and large business groups that was exposed by the crisis at the end of the century.</p> <p>The lack of regulation and oversight policies meant that the new financial and geographical axis began to become heavily concentrated as private-sector banks in particular forged close links with importers, with the media that monopolized public opinion and communication and with the State.</p>	<p>The constituent process that began in November 2007 forced the financial sector to cut its ties to firms in other sectors. Similarly, the approval of question 3 in the referendum and the popular consultation of 7 May 2011 impacted the media.</p> <p>A higher tax on bequests, legacies and donations is being debated.</p>

Source: Prepared by the author, on the basis of data from Central Bank of Ecuador, *Información Estadística Mensual*, No. 1971, Quito, 2016; and Economic Commission for Latin America and the Caribbean (ECLAC), *Foreign Direct Investment in Latin America and the Caribbean 2011* (LC/G.2538-P), Santiago, 2012.

In seeking to understand these changes, Marconi (2001, p. 11) argued that “dollarization is not simply an alternative management model that can be studied with conventional tools [...] but must be interpreted mainly from the standpoint of political economy, since its conception, its methods of application and the people chosen to implement it are clearly determined by the interests of well-known business groupings with strong ties to the political and social spheres and the media.”

On this view, it was not the monetary regime that provided the conditions of economic stability needed for per capita incomes to increase and for the country to avoid the greatest crisis of capitalism since the Great Depression. There are two reasons for this: first, economic policymakers during the new neoliberal dispensation created three “contingency” funds that inhibited economic growth and made fiscal policy unusable in possible recessions, whether due to domestic or external factors.¹⁵ Second, dollarization in itself has inhibited economic growth, since it leaves the country without a monetary and exchange-rate policy to mobilize domestic saving, expand exports and replace imports, and deal with external shocks.

Trade is the main channel of transmission for these shocks.¹⁶ This could happen in two scenarios: a fall in the oil price and a slump or boom in the United States economy. Together or separately, these scenarios would cut short Ecuador’s rapid development of recent years. The current monetary regime means that the effect of outside shocks can be transmitted more directly and far more quickly.

A slump in the United States economy would have deep repercussions in the global economy, as it would cut trade flows between developed and developing countries and depress demand for

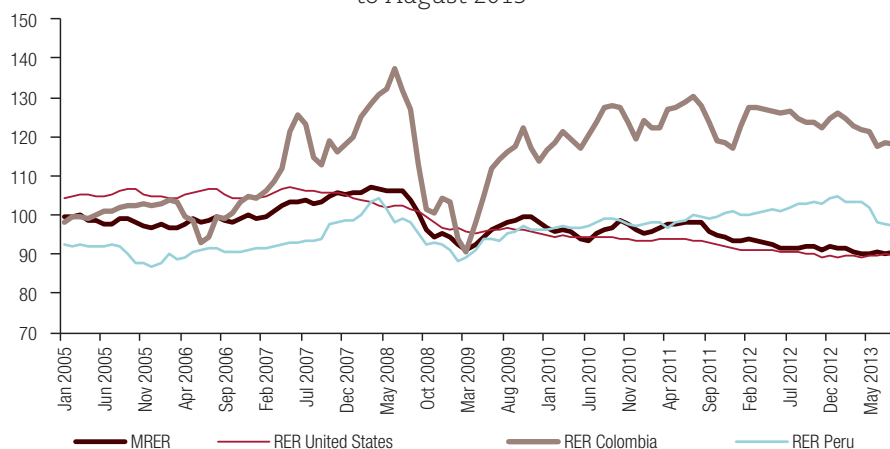
¹⁵ They were called “contingency” funds because their intended purpose was to cushion the kind of external shocks that send the business cycle into a downturn. Nonetheless, the way these funds were allocated did not live up to their name, as 70% of the resources from the sale of heavy crude (the second oil fund was set up on 25 March 2002, while the first, drawing on sales of light crude, had been set up under the Economic Transformation Act of 13 March 2000) were used to repurchase external public debt at market value (Paredes, 2015).

¹⁶ According to Coq (2007), the Convertibility Plan depended on capital flows because external trade to the United States accounted for just 16% of the total (in 2007 the figure was 7.44%). In other words, the financial channel prevailed over the trade channel. The effects of external shocks on the passive monetary integration carried out by Ecuador and Argentina differ in their transmission channels. The announcement that the Ecuadorian currency was being abandoned was made in an international context where capital flows were leaving emerging countries because of the successive financial crises of the late 1990s. When a country cedes sovereignty over its monetary policy, it creates a leader-follower relationship.

Latin America’s main export products, including oil. Another scenario is the United States economy operating at full capacity and with a high level of productivity, which could allow the dollar to strengthen.

A slump in the United States economy could affect Ecuadorian exports in respect of both prices and volumes, as happened during the international financial crisis of 2008-2009. Since the second half of 2011, with a weak recovery in the United States economy but without the problems of the European periphery, Ecuador’s multilateral real exchange rate (MRER) has so far tended to appreciate, without showing any signs of returning to earlier levels, irrespective of the base year used to calculate it (see figures 4 and 5).¹⁷

Figure 4
Ecuador: multilateral real exchange rate and main trading partners, January 2005 to August 2013^{a,b}

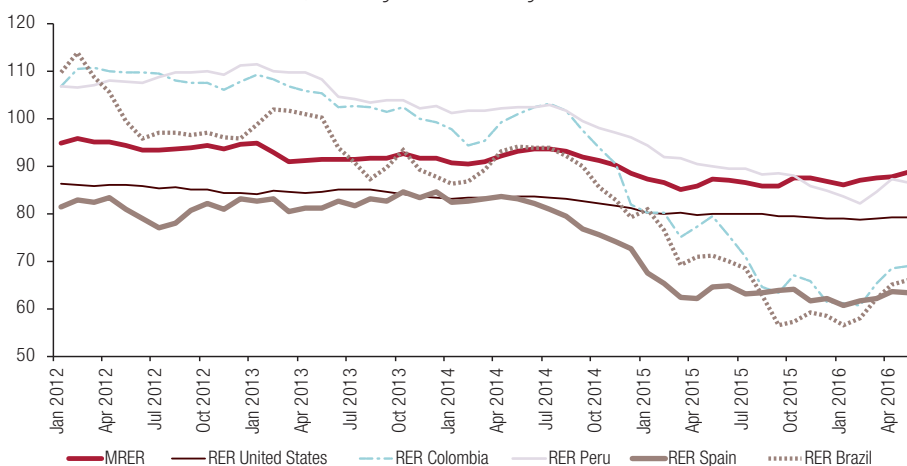


Source: Prepared by the author, on the basis of data from Central Bank of Ecuador, *Información Estadística Mensual*, No. 1886, Quito, 2009 and *Información Estadística Mensual*, No. 1951, Quito, 2014.

^a Base year 1994 = 100; RER: Real exchange rate; MRER: Multilateral real exchange rate.

^b Sample of the 18 countries that trade most with Ecuador, excluding trade in oil.

Figure 5
Ecuador: multilateral real exchange rate and real exchange rates with major trading partners, January 2012 to May 2016^{a,b}



Source: Prepared by the author, on the basis of data from Central Bank of Ecuador, *Información Estadística Mensual*, No. 1971, Quito, 2016.

^a Base year 2007 = 100; RER: Real exchange rate; MRER: Multilateral real exchange rate.

^b Sample of the 22 countries that trade most with Ecuador, excluding trade in oil.

¹⁷ The behaviour of the real exchange rate relative to the United States has a strong influence on the MRER, highlighting the importance of the United States economy and its business cycles.

Whereas on the export side the dependence on oil and real exchange-rate appreciation can be perceived, on the import side two structural problems can be pointed out: (i) import demand that is highly elastic to changes in industrial output and economic growth, and (ii) the inability to produce oil derivatives to meet domestic demand.

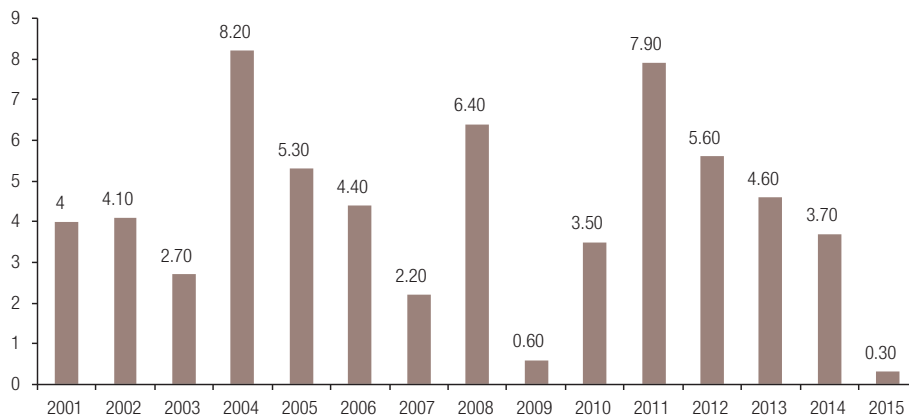
4. Dollarization constrains the scope for high and sustained economic growth

It has been mentioned that passive monetary integration (dollarization and convertibility) has been very successful in reducing inflation but not in establishing a pattern of sustained growth. Where macroeconomic policy is concerned, post-convertibility Argentina was characterized by a competitive and stable real exchange rate, a build-up of reserves, recovery in real wages and control of inflation (Heymann and Ramos, 2010).

Underlying these policies was the commodity boom, yielding high and sustained growth in the economy that was only undermined by the global financial crisis and by some very particular features of that economy (a high rate of unionization and unsound monetary and fiscal policies).

Ecuador was formerly in an international context identical to Argentina's, but had a quite fluctuating growth rate that was lower on average than the latter's (see figure 6). The reasons are to be found in economic policy decisions during 2000-2006, which compressed domestic demand, and of course in the monetary regime. Income inequality remained high and unchanging.¹⁸

Figure 6
Ecuador: economic growth rate, 2001-2015^a
(Percentages)



Source: Prepared by the author, on the basis of data from Central Bank of Ecuador, *Información Estadística Mensual*, No. 1971, Quito, 2016.

^a Base year = 2007.

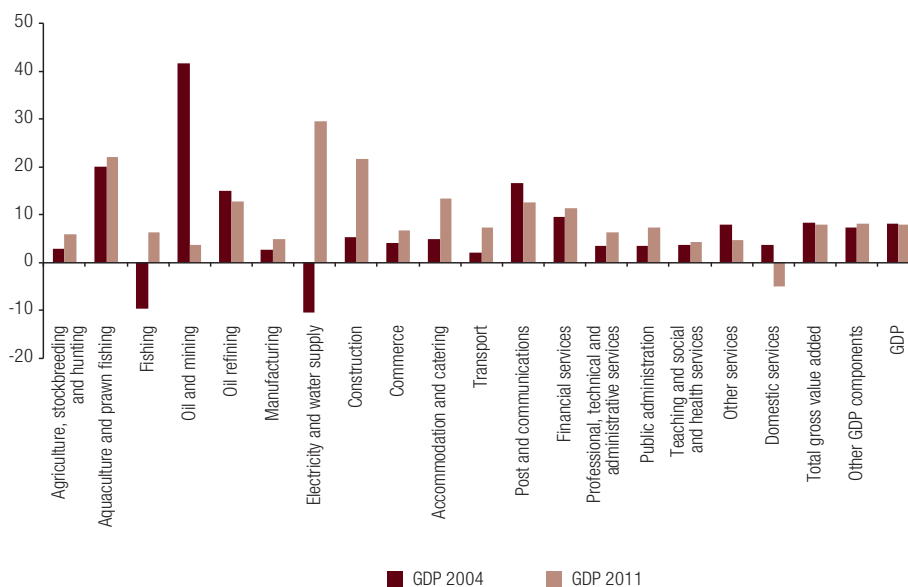
In a column titled “Inequality is holding back the recovery” published in *The New York Times* on 19 January 2013, Stiglitz argued that whereas we used to ask how much growth we would be willing to sacrifice for a little more equality and opportunity, we now realized that we were paying a high price for our inequality and that alleviating it and promoting growth were intertwined, complementary goals (Stiglitz, 2013). It follows from Stiglitz’s column that the nostrum “first grow, then share” (so often

¹⁸ Pacheco (2009, p. 53) explains that Ecuador’s dollarization period up to 2006 was characterized by profound instability and inequality in development, albeit with fairly stable prices. According to that author, the Gini coefficient was 0.58 in 2000-2005.

defended by economists of the neoliberal dispensation in Ecuador) was not fulfilled (as was also demonstrated in Ecuador in 2007-2013).

The highest economic growth rates since dollarization were in 2004 and 2011. If these rates are analysed comparatively, though, the results are very different. The activities contributing most to the expansion of the economy in 2004 were oil and the extraction of mineral resources, yielding 41.7% of total growth. In 2011, conversely, the activities generating most jobs were aquaculture and prawn fishing with 22.1% and construction with 21.6%. Fishing grew by 6.2% in 2011, whereas in 2004 it shrank by 9.7% (see figure 7).

Figure 7
Ecuador: gross domestic product (GDP) growth by economic sector, 2004 and 2011^a
(Percentages)



Source: Prepared by the author, on the basis of data from Central Bank of Ecuador, *Información Estadística Mensual*, No. 1951, Quito, 2014.

^a Base year = 2007.

What matters is not just growth, but the kind of growth. Whereas 2004 saw one of the two highest rates of economic expansion in the period, the effects were not reflected in the population, especially in the Gini coefficient (which held steady) and the unemployment rate, which was in excess of 9% of the economically active population.¹⁹ In 2011, conversely, high growth went along with an improved distribution of wealth: the region's third-best Gini coefficient, an unemployment rate of about 5% and the largest reduction in poverty and indigence in Latin America. Specifically, indigence fell to single digits (9.4%) for the first time in June 2012 (ECLAC, 2012a and 2013).²⁰

Considering that Ecuador's (unilateral) dollarization does not provide the optimum conditions for an intensive and sustained process of capital accumulation, and that it constitutes a rigid currency regime, the following may be noted:

¹⁹ See *El Universo* newspaper, "La macroeconomía no da de comer a los pobres" [online] <http://www.eluniverso.com/2005/05/01/0001/21/5DF504F40EFE4E329331EDA4EC230FE4.html>.

²⁰ The unemployment rate reached its lowest point in the whole period of dollarization in September 2014 (3.90%). That same month, the poverty and indigence rates were 24.75% and 8.56%, respectively, and the (urban) Gini coefficient was 0.4619.

- (i) From the Research Department of the International Monetary Fund (IMF), Ghosh, Qureshi and Tsangarides (2013 and 2014) point out that fixed exchange rates impede external adjustment: external disequilibria (current account surpluses or deficits) are less persistent in floating exchange-rate regimes, which reduces the chances of dangerous imbalances building up and leading to a crisis. This argument was earlier developed by Milton Friedman in his 1953 essay “The Case for Flexible Exchange Rates.”
- (ii) Rodrik (2008) demonstrates the correlation between growth and the real exchange rate. As Frenkel (2008) put it in relation to the effects of a stable and competitive real exchange rate (SCRER): “Although the scale and evolution of the SCRER effect on aggregate demand may be difficult to pinpoint, we do know that the higher growth experienced by economies which adopt an SCRER is partly due to this effect.”
- (iii) Stress should be laid on the non-neutrality of money in the short and medium run as postulated since the 1930s by J.M. Keynes and the post-Keynesians, i.e., the link between the monetary and real spheres (Guttman, 1996).
- (iv) The concept of non-neutrality also appears to be valid in the long run. Blanchard (2003) argues that an active monetary policy has lasting effects on interest rates and thence unemployment. A steady rise in the real interest rate will lead to a high unemployment rate that, given its duration, the decline in capital accumulation and the effects on firms’ profit margins (higher financial outlays), will cause the natural rate of unemployment to rise. A sustained drop in the real interest rate will produce the opposite sequence.

The initiative of creating degrees of monetary policy in an economy without a currency of its own was based on what Blanchard (2003) has demonstrated. The repatriation of capital in Ecuador since 2009 (and the reduction in lending interest rates) shows that it not only helped the country avoid the shocks of the international financial crisis, but contributed to the reduction of the natural rate of unemployment. Depositors’ savings abroad that returned to the country did not serve to cushion a possible bank run but to expand private lending and galvanize production and employment.

5. The main condition for the new production matrix: the restoration of foreign exchange policy

The last reason to exit dollarization is to be able to construct a new production matrix. The experience of the Asian tigers (Hong Kong Special Administrative Region of China, Indonesia, Japan, Malaysia, the Republic of Korea, Singapore, Taiwan Province of China and Thailand) reveals the need for the exchange rate to be kept weak to promote exports, especially those of nascent industries.

Frenkel (2008) and Frenkel and Rapetti (2009) 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. Another argument is that, unlike other incentive systems, this general policy of promoting marketable activities (over non-marketable ones) does not give rise to rent-seeking.

The insistence on keeping the dollar as the national currency would seem to entail a dependence on its being weak in the long run, which is very unlikely. The current disadvantage of Ecuador’s relative prices with its main trading partner (see figures 4 and 5) is a serious problem for the country’s export sector, considering that, as Falconí and Oleas (2004) put it, “dollarization suffers from a number of deep-seated problems, the most serious of which is structural with long-run effects on the country’s economy: productivity.”

IV. Conclusions and closing reflections

Since the announcement and implementation of dollarization in Ecuador, the representatives and proponents of this monetary regime have used all possible means (economic, political and social) to bolster it.²¹ Their main instrument has been the creation in the social imaginary of the idea that it simply cannot be abandoned, since any attempt to cast doubt over this regime would leave the Ecuadorian economy in the worst of all worlds.

In Ecuador, the ultimate goal of economics has shifted in the last decade from the monetary regime to human beings as the core of society. This conceptual change was indirectly responsible for the survival of dollarization over time, since the economic structure designed during the 2000-2006 period would have brought about the collapse of the monetary regime because of the severe effects of the financial crisis in the central countries, transmitted through trade.

Between 2000 and 2006, the financial and economic ruling class of Ecuador created laws, regulations and ideas whose aim was that every effort of society's should contribute to the survival of dollarization, even in downturns. Ensuring this meant high rates of return for sectors connected to this regime (and its policies), which is why people speak of a political economy of abandonment of the national currency.

Dollarization thus becoming an end in itself not only continued to set back the country's economic development, but suppressed it to the point of turning this impaired development into a political process that came to seem irreversible from 2007. Ecuador's suppressed development led to the mode of regulation being transformed via changes in its institutional forms and, subsequently, the accumulation regime.

Transformation of the mode of regulation began with the reorganization and reinstitutionalization of the State countrywide and continued with the other institutional forms. The accumulation regime and the workings of Ecuadorian capitalism were also transformed on the premise that human beings were the ultimate end of society. To prevent this change from being easily reversible, however, it is indispensable for dollarization to be abandoned. Economic development itself, which drove the transformation of the mode of regulation, requires the restoration of monetary sovereignty to entrench this transformation.

Dollarization has had structural impacts on the distribution of power in Ecuador. Abandoning it would have them too. The most advisable course would be to do it at a time when transformation of the State and employment relations were in a dominant position and in a context where a far-reaching progressive distribution of income was in progress. Otherwise, the way would be open, as Acosta (2004) very rightly points out, for the oligarchical groups that gained from dollarization to do so again and for the representatives of "orthodox, conservative and prudent" economics to seek an exit based on neoliberal principles.

²¹ The latest effort of this kind was made by the Inter-American Business Federation (FIE) in September 2014 when it proposed a public-private partnership law whose objective was to change the economic policy of the previous six years, with its focus on high public spending. Other business leaders rejected the proposal, arguing that the government ought to cut public spending without partnerships of any kind.

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