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DOLLARIZATION, A PROCESS OF FINANCIAL STABILITY IN ECUADOR

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Abstract: Ecuador dollarized its economy as a solution to the crisis of the 1990s, which was characterized by increased poverty, unemployment, massive closure of MSMEs, and the loss of savings in the financial system following the liquidation and closure of the country's largest banks (Filambanco; Progreso; Previsora), rampant inflation (Central Bank of Ecuador, 2005) eroded purchasing power, which increased the prices of basic necessities, and a volatile exchange rate with daily increases. The government's strategy to address the crisis was to increase inorganic issuance, which increased social uncertainty and economic turmoil. Political uncertainty and the lack of credibility in the financial system prevented adequate solutions from being found to address the crisis (Bekerman, 2001) .

In this context, several alternatives were analyzed to address the crisis that shook the country's social and economic landscape. Monetary convertibility with the issuance of a new currency linked to a foreign currency, and the adoption of the dollar as the currency of circulation and acceptance among the population (Acosta, 2001) . The decision to adopt the US dollar had immediate positive effects in the short term, with the readjustment of prices for products and services (Jácome, 2004) , real estate, basic necessities, a reduction in credit interest rates, a drop in inflation, and renewed confidence in the financial system (Correa, 2004) .

Keywords: Dollarization, finance, economic crisis, monetary policy.

INTRODUCTION

Dollarization is a complex economic phenomenon that has had a significant impact on several developing countries, transforming macroeconomic structures, including Ecuador, since its implementation in 2000. It has undergone profound changes in financial intermediation, the production system, and legal regulations since the 2008 constitution. This research focuses on examining the effects of the implementation of dollarization on the Ecuadorian economy with the aim of exploring the theoretical assumptions that underpin a dollarized economy and their specific application in the context of economic instability in the Ecuadorian case.

Dollarization ushered in a new economic, financial, productive, and political era in Ecuador. The purchasing power of the population grew, allowing them to invest in movable and immovable property, vehicles, technology, and machinery at international prices, which lowered the local market. Inflation fell to single digits, remaining stable between 1% and 3% despite global crises such as those of 2008, COVID 2020-2021, and internal crises in 2022-2025 without major impacts on the economy. The level of domestic savings improved, and liquidity strengthened in the financial system. However, all this positive effect was not matched by the public policy system, where the Central Bank of Ecuador has not established a rule to ensure the effective management of credit and deposit rates (Andrade R. &., 2023) , which have remained above double digits for all active operations in the financial system, with increasing benefits for financial intermediaries, harming the population to the point of over-indebtedness relative to their income levels (Central Bank of Ecuador, 2024) . The lack of management and social responsibility on the part of banks and cooperatives, in collusion with the governments in power, sets the stage for a new internal financial crisis in the short term.

The positive effects of dollarization did not lead to a modernization of public policies. The Central Bank of Ecuador has not implemented effective regulations for the regulation of lending and deposit rates, which has led to a regressive credit structure.

Lending rates remain above 10% for most transactions, favoring financial intermediaries and harming the indebted population, with alarming effects on household over-indebtedness (Andrade & Andrade, 2023; BCE, 2024).

The contradiction between the increase in liquidity in the financial system, with total deposits reaching USD 63 billion and a loan portfolio of USD 65.5 billion in February 2025 (ECB, 2025) compared to the government's lack of liquidity requires study and analysis to find the origin and causes of this deviation, which appears to be due to the inefficient management of the control bodies responsible for combating money laundering.

This highlights a disconnect between financial growth and the real economy, in a scenario marked by internal insecurity, shrinking consumption, deteriorating employment and production, and a Gross Domestic Product (GDP) that has fallen for three consecutive quarters, suggesting a process of economic recession (National Institute of Statistics and Census [INEC], 2025).

Dollarization has had a number of advantages and disadvantages since its inception (2000), which have had an impact on the country's economy:

Advantages.

- The Ecuadorian economy eliminated the risk of currency devaluation, helped reduce inflation, and generated confidence in the financial system.
- The financial system has invested in IT systems that facilitate international financial transactions with greater access to global markets.
- The country risk rating stood at 859 basis points (Ecuador, 2025) as of June 2025, the lowest in the last two years of the new government's administration, reflecting renewed confidence from international investors and multilateral credit agencies.
- The risk of exchange rate fluctuations and currency devaluations has been eliminated. However, political management and internal risk linked to drug trafficking and paramilitary groups have prevented resources from flowing into domestic investment, which has been a determining factor in the contraction of production and job creation.
- The government has restored greater fiscal discipline and has had to control public spending to avoid financial imbalances.
- Nevertheless, the government maintains an inorganic issuance of fractional currency with no market value, resulting from two issuances at the beginning of dollarization, which in February 2024 totaled 85.6 million in fractional currency, producing inconsistencies in the Central Bank's management of liquidity.
- Purchasing power increased, contributing to the elimination of economic and social inequality, as the most vulnerable sectors can be included in sustained economic development through public policies.

Disadvantages.

- The government lost its ability to use monetary policy as a tool to stimulate the economy in times of recession or crisis.
- Dollarization exposes the country to the economic policies and fluctuations of the US economy, which can limit its ability to respond to external shocks.
- It does not have its own currency, and since it cannot devalue its currency, Ecuador faces greater difficulties in adjusting its trade balance and correcting external imbalances.

The lack of public policy to strengthen the productive process and allow investment in technology prevented the development of internal strategies to project ourselves onto the international market with competitive technology-based products and services.

METHODOLOGY

The study begins with a qualitative documentary approach, compiling, reviewing, analyzing, and synthesizing documents and sources from public and private agencies and organizations, as well as other documents related to dollarization in Ecuador.

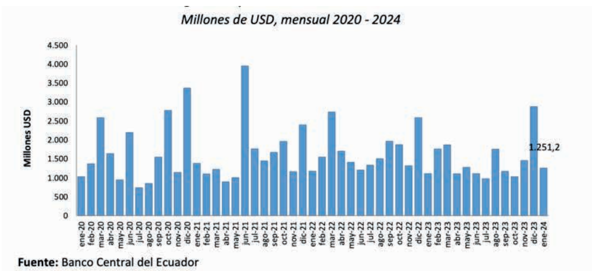
The information gathered will be critically analyzed to identify patterns, trends, and divergent views on the effects of dollarization on the Ecuadorian economy.

The proposed qualitative documentary analysis offers a rigorous and critical perspective on the effects of dollarization on the Ecuadorian economy. By better understanding the theoretical assumptions and practices associated with dollarization, economic and monetary decision-making in the Ecuadorian context can be more effectively informed and important lessons can be provided for other countries facing similar decisions.

ANALYSIS

The Ecuadorian economy is undergoing a process of political, economic, and social transition unprecedented in the world. The government has declared war on terrorist drug groups operating in the country and is proposing fiscal adjustments in the form of tax increases, with the aim of raising approximately $1.9 billion to add to the general state budget (PGE). The increase in value added tax from 12% to 15% will generate 1.105 billion in revenue; a tax on bank and cooperative profits will generate 201 million; and contributions from companies will generate 609 million in Special Drawing Rights ( ) earmarked for internal war requirements with serious repercussions for the Ecuadorian economy (BCE, 2025) . This action allowed access to an economic aid loan due to lack of liquidity of 4.5 billion in Special Drawing Rights (SDR) from the International Monetary Fund to overcome the government's liquidity crisis. (International Monetary Fund, 2024) .

In this scenario, the increase in the liquidity of the Ecuadorian financial system (Central Bank of Ecuador, 2024) The Financial Outlook prepared by the Central Bank of Ecuador (BCE) and Other Deposit Companies (OSD) showed a total liquidity balance of USD 79,308.7 million, a money supply of USD 29,914.0 million, and currency in circulation of USD 19,496.5 million



The increase in the financial system's liquidity means that there is more money in financial intermediaries, generating positive effects such as:

1.- It facilitates access to credit for businesses and individuals, which could stimulate inclusion, investment, and consumption in scenarios of certainty.

2.- Liquidity in the financial system contributes to improving its ability to manage and increase its market share, making it more likely that its solvency will maintain and increase user confidence.

In this context, the negative aspects to consider may be:

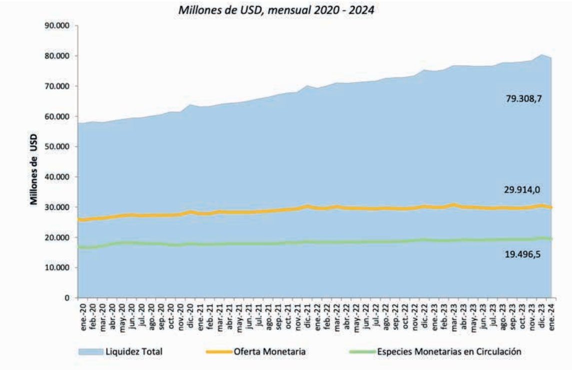
1.- An increase in liquidity levels in the economy could generate inflationary pressures if not accompanied by adequate public policy to strengthen the production of goods and services. This could erode the purchasing power of the population and negatively affect the most vulnerable sectors.

However, the behavior of liquidity is contrary in the country because it is not possible to quantify the cash that appears as a result of money laundering, including the weak control of national agencies. In contrast, inflation remains on a downward trend, The liquidity of vulnerable sectors is offset by financial assistance from loans originating from money laundering, which are occupying the sector intended for social economy cooperatives.

2.- The increase in the liquidity of the financial system has benefited financial intermediaries, which over the last two decades have achieved results exceeding USD 20 billion, and those with access to credit have been impoverished by high legal usury rates, increasing economic inequality if adequate policies are not implemented to promote a more equitable distribution of wealth. (Andrade R., FINTECH, 2024)

3.-Despite increased liquidity, slow economic growth and rising unemployment may limit the population's ability to take advantage of credit opportunities and investments, which could perpetuate or even exacerbate economic and social problems.

The growth of liquidity in Ecuador's financial system in a context of low economic growth and rising unemployment poses challenges and opportunities. It is crucial that financial and economic authorities adopt appropriate policies to manage liquidity effectively and promote inclusive and sustainable economic growth. This may involve measures to encourage productive investment, improve financial regulation, and promote financial inclusion to ensure that the benefits of economic growth are shared equitably among all segments of society.



Fuente: Banco Central del Ecuador

In this context, we analyze the variables that impact the development and inclusion of informal sectors in the social economy.

1. When GDP declines, it leads to a reduction in overall economic activity. This reduces income for MSMEs and individuals, which in turn can lead to a decline in credit demand and lower investment. Financial intermediaries (banks and cooperatives) may face lower demand for loans, returning to a financial strategy of accumulating more liquidity as a precaution against increased credit risk.

2. Rising unemployment can lead to a decline in household income and increased economic uncertainty. This can lead to a reduction in consumption and investment, which in turn can affect credit demand and the liquidity dynamics of the financial system. In addition, rising unemployment can lead to an increase in loan delinquencies and greater risk aversion on the part of banks.

The growth of financial system liquidity could be boosted by public policies in emergency economic legislation.

- By implementing policies that stimulate an increase in the liquidity of the financial system as part of a package to counteract the economic recession and economic , such as interest rate cuts or liquidity injections through asset purchase programs.
- In times of economic uncertainty, banks may choose to hold more liquidity as a precautionary measure, which could increase the liquidity of the financial system as a whole.

The situation poses a significant challenge for the Ecuadorian economy and highlights the disconnect between the dynamics of the financial system and job creation.

1. Financial system dynamics. The Ecuadorian financial system is active in terms of resource mobilization, with a significant volume of deposits and loans. This suggests that financial intermediaries are generating income and earning profits from their operations.

2. Job creation. The employment situation is worrying, with high levels of unemployment and underemployment in relation to the economically active population (INEC, 2025) . The gap between the number of people in dependent employment and those who are unemployed or underemployed is significant and reflects an imbalance in the labor market.

3. Structural challenges. This imbalance can be attributed to several factors, including structural challenges in the economy, such as a lack of productive diversification, dependence on labor-intensive sectors, and the presence of a significant informal economy. These factors make it difficult to create enough jobs to absorb the entire available labor force.

4. Social and economic impact. The lack of adequate employment not only affects the individual well-being of people, but can also have negative repercussions on the economy as a whole, including lower demand for goods and services and slower economic growth.

5. Need for integrated policies. A comprehensive strategy is required that combines policies aimed at strengthening the financial system with measures designed to promote sustainable and quality job creation. This could include incentives for investment in labor-intensive sectors, training and education programs to improve the employability of the workforce, and policies to promote the formalization of employment.

In this perspective, the decline in gross domestic product (GDP) is closely linked to the imbalance between the dynamics of the financial system and job creation. This is related to factors such as:

1. Lower economic activity. A decline in GDP indicates a contraction in the country's overall economic activity. This can result in lower demand for loans from businesses and consumers, which could affect the profitability and activity of the financial system.

2. Impact on employment. A decline in GDP can lead to a reduction in job creation and an increase in unemployment. This, in turn, can affect people's ability to access financial services and meet their financial obligations, which could impact the stability of the financial system.

3. Credit risk. Slower economic growth may increase the risk of loan defaults by MSMEs and individuals, which could affect the balance sheets of banks and other financial institutions and increase the likelihood of financial crises.

4. Need for countercyclical policies. In a context of declining GDP, it is important for economic authorities to implement countercyclical policies to stimulate the economy and promote job creation. This could include fiscal, monetary, and financial measures aimed at boosting aggregate demand and promoting investment and consumption.

CONCLUSIONS

1.- GDP decline can have a significant impact on the dynamics of the financial system, job creation, and overall economic stability. It is important to address the underlying causes of economic decline and take measures to promote sustainable and inclusive growth that benefits society as a whole.

2.- The lack of balance between the dynamics of the financial system and job creation in Ecuador is a major problem that requires attention and coordinated action by government, business, and social actors to address its underlying causes and promote more inclusive and sustainable economic growth.

3.- It is important to bear in mind that an increase in the liquidity of the financial system does not necessarily translate automatically into an increase in the availability of credit for households and MSMEs, especially if credit demand is weak due to economic recession and rising unemployment.

4.- Twenty-five years of dollarization for Ecuadorians have generated greater stability and the possibility of sustained development, improving the quality of life.

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