

Ecuador: economics and politics of the citizen's revolution, preliminary assessment

Ecuador: economía y política de la revolución ciudadana, evaluación preliminar

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Research Article

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Abstract

This article analyzes some facts linked to the dollarization program carried out in 2000 and its positive effects in the macroeconomic stabilization of Ecuador, the reduction in inflation, interest rates and its impact on investment, as well as economic growth and poverty reduction. It also reviews fiscal expenditure on social and economic infrastructure as an additional variable of economic policy in order to foster employment, economic growth and the general welfare of the population. This paper concludes that dollarization was the key factor in helping the fiscal policy to achieve significant economic and social development.

Keywords: dollarization, stabilization, inflation, growth, social expenditure, fiscal policy.

JEL: F33, E63, E31, F43, H50, E62.

Resumen

Este artículo analiza algunos hechos derivados del programa de dolarización llevado a cabo en 2000 y sus efectos positivos en la estabilización macroeconómica del Ecuador, la reducción de la inflación, la tasa de interés y su impacto en la inversión, así como el crecimiento económico y la reducción de la pobreza. También revisa el gasto fiscal en infraestructura económica y social, como variable complementaria de la política económica para promover el empleo, el crecimiento económico y el bienestar general de la población. El estudio concluye que la dolarización fue el soporte inicial que ayudó a la política fiscal a la obtención de importantes logros en materia de desarrollo económico y social.

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Palabras clave: dolarización, estabilización, inflación, crecimiento, gasto social, política fiscal.

INTRODUCTION

Within the economic, political and social context of Latin America over the last 15 years, and especially in countries like Venezuela, Ecuador, Bolivia, Nicaragua and Argentina, a step was taken towards new ideologies and policies, the purpose of which was to experiment with new models of economic development with the intention of solving urgent matters of a structural nature related to growth, unemployment, the fight against poverty and income inequality. In order to resolve such problems, new approaches such as “21st century Socialism” in Venezuela, Ecuador and Bolivia were proposed; with different degrees of intervention from the state in economic activity and the construction of socialism, from the non-intervention of the market, like in Venezuela, to a combination of the market and the state.

The Republic of Ecuador was not alien to that purpose, as the serious economic and social problems it experienced, together with the financial crisis of 1999, as well as the fragility of the political parties and democracy, paved the way for “21st century Socialism” in 2007, ... in the programs of “Social revolution and socialism for wellbeing” of the current president, Rafael Correa. He was re-elected through popular vote, given, so it seems, to the efficacy of his model to improve the economic and social conditions, and to re-design the “Productive matrix of Ecuador.” This situation brings about a question that is meant to be discussed in this work: What general factors contributed to the efficacy of the Ecuadorian model?

Due to the above, the aim of the present article is to contribute to the discussion so as to determine the governmental policies and actions that led the country to reduce poverty by 10 percentage points, improve the distribution of income and the index of human development - IDH- (0724 in 2012), achieve an average growth of 4.3 % in the period 2007–2013, democratize health and education, apart from generating the pre-condition for the take off and the modernization of the country in the present millennium (Senplades, 2012).

The discursive analysis of this work is guided by the following statement: *the economic-political model of Ecuador, from the period 2007–2013 of the “Citizen’s Revolution,” had as the booster of the initial economic growth the dollarization program imposed in 2000 and, based on a political and economic proposal, the main factors of which are the state and the efficacy of public expenditure, it was possible to maintain the initial economic growth, which was translated into important economic and social achievements.* To develop the topic, a descriptive analysis with primary sources represented in the speeches of President Correa is used, as well as secondary sources from journals, newspapers and theoretical articles on specialized topics. The article is divided into two main sections: in the first, the ideological and political argumentation of the current model of the Citizen’s Revolution is approached; the second, describes and analyses the economic implementation of the model, same as the productive structure of Ecuador. Finally, it is concluded that the Ecuadorian model has been relatively successful.

IDEOLOGY AND POLICY OF THE ECUADORIAN MODEL

General aspects

In the last decades, Latin America has experienced diverse economic, social and political changes, which led to the current reality of the region. This can be seen at the beginning of the 21st century in countries, such as Ecuador, Bolivia, Chile, Colombia and other Ibero-American nations. Years before, the previously mentioned countries proposed diverse government and economic management schemes, as well as different ideologies and programs, some in the framework of so-called liberal democracy, with growing participation of the market; others, of a clear populist contrast and the great intervention of the state, such as those who called themselves “21st century Socialism” (Arévalo, 2008).

The objective of the new economic and political models was oriented towards the search for growth and national development, and the redemption of the less favoured sectors of the population, for which new paradigms and processes of social change were put into action. The new government and economic management schemes were nurtured, in addition, by the diverse ideological sources, of liberal content in some cases, and in others they were highly influenced by strong social-democracy and Keynesianism.

Some of the reasons for the change in direction of Latin America towards new experiments of economic and social policy were, among others, the poor response of the predominating models regarding the solution of poverty and the reduced economic growth of the different nations. In the Ecuadorian case, an important element for the delay in its economic growth was the fragmentation of the partisan system and their inefficacy in the role of intermediaries between the political power and the population through *bargaining*.

The traditional parties and the economic and political power elites were permeated by corruption and the theft of the resources of the state. Latin America was not alien to corruption, as can be observed in the following table.

Table 1. Perception of corruption in Latin America indexes 2002 - 2007

CORRUPTION PERCEPTION RATES					
PLACE	COUNTRY	CPR/2002	CPR/2003	CPR/2004	CPR/2007
1	Chile	7.5	7.4	7.4	7.0
2	Uruguay	5.1	5.5	6.2	6.7
3	Brazil	4.0	3.9	3.9	3.5
4	Peru	4.0	3.7	3.5	3.5
5	Colombia	3.6	3.7	3.8	3.8
6	Mexico	3.6	3.6	3.6	3.5
7	Argentina	2.8	2.5	2.5	2.9
8	Venezuela	2.5	2.5	2.5	2.0
9	Ecuador	2.2	1.6	2.2	2.1
10	Bolivia	2.2	2.4	2.4	2.9
11	Paraguay	2.0	2.2	1.9	2.4

Source: International transparency

(*) The lower the rate, the higher the degree of corruption.

The Corruption Perception Rate (CPR) is a compound index and it is based on surveys with reports related with the corruption of many and varied institutions.

Similarly, and in order to foster growth and macroeconomic stability, some countries of the region applied recipes formulated by the Washington Consensus. With this, they also sought to promote employment, structural change, and the opening to foreign countries, without leaving behind fiscal balance and the promotion of health and education systems. The policies applied, same as the reforms carried out, did not always achieve the expected goals and, for this matter, it was not possible to solve the urgent problems of poverty and marginality. Some governments looked for and applied alternative economic models in their respective countries, in the case of Ecuador, as from 2006, the “21st century Socialism” and the “Citizen’s Revolution” were implemented, the purposes of which are, precisely, to favour economic take off, industrialization and the wellbeing of the citizens.

“21st century Socialism”

The Ecuador prior to the time of President Rafael Correa was characterized by permanent poverty, social inequity and lagging economic growth. In the political field, the corruption of the elites and of the partisan system made clientelism relations fragile and, for that same reason, they paved the way for new experiments and political practices (Hurtado, 2006), and like in the other aspects mentioned, failed public policies did not present a final solution to the problems of the health and education systems, nor to social marginality. The Andean nation of the beginning of the millennium was also characterized by growing stability and a permanent succession of different governments which, instead of bringing solutions, deepened the economic, social and political problems of the Ecuadorian nation with growing corruption in its different levels of government: central, provincial and cantonal.

Political instability, in part a product of the economic crises, and high inflation rate, led to the ousting of the former presidents Abdalá Bucaram in 1997, Jamil Mahuad in 2000 and Lucio Gutiérrez in 2005. Gutiérrez was deposed by what he himself called *La Revolución de los Forajidos* (the Revolution of the Bandits), a political movement in which the current president, Rafael Correa, took part.

When Correa took office in 2007, his government adopted some ideas of the so-called “21st century Socialism,” a concept created and disseminated in 1996 by Heinz Dietrich Steffan (n.d), adopted by Hugo Chávez in Venezuela for his project of constructing a new society, and also in Bolivia by Evo Morales, with the same purpose of empowering the marginalized social groups of the society.

It is important to note that some of the principles of the political philosophy of “21st century Socialism” were the fundamentals of the movement or political party *Alianza País* (Country Alliance), of Ecuadorian President Correa. In the economic practice, the model is nurtured by sources and programs that defend a great intervention of the state in economic activity, in consonance with the Keynesian policy that privileges protagonism and an important role of the

governmental apparatus, and includes clear ideas of welfare in the social field, which places *Alianza País* as a political movement with a populist tendency.

In the words of Gustavo Larrea, minister and ideologist of 21st century Socialism and *Alianza País*, with these the government seeks to give power to the people, power represented in all the aspects: economic, social and political, in order to carry out the “Citizen’s Revolution” in Ecuador (2013).

When he took office and in his different speeches to the people, Correa explained what for him and the ideologist was understood as “21st century Socialism.” According to them, it differs from traditional socialism, given that it does not contemplate the ownership of the means of production by the state, although it is pivotal to fostering production and economic growth in Ecuador. “21st century Socialism” has its grounds in collective action and not in individualism, as is the case of capitalism. In this sense, the socialism of the Ecuadorian system defends the preponderance of collective social action over the individual and the market. It also rejects class struggle, as well as the doctrine and economic and political fundamentalism. Similarly, the “21st century Socialism” of Ecuador defends private property, although with strong regulations from the state and, for that reason, it distances itself from the Venezuelan view of Chavez of building a similar system to that of Cuba.

Citizen’s Revolution

According to the ideologists of *Alianza País* and the Citizen’s Revolution, the development of Latin America is not the result of structural causes; it has its political fundament, or comes from certain power relations imposed by the ruling class in detriment of the less favoured sectors of the population. For this, if in Latin America there is no change in the relations of power, there will not be economic development for the great majorities. The Citizen’s Revolution is this change, as long as the legislators and others who represent the people do not continue to represent themselves (Hoy, 2009).

The political ideology of the Citizen’s Revolution was inspired by liberal ideas defended more than a hundred years ago by Eloy Alfaro, which were put down in a citizen’s political movement, the purpose of which was to end with the institutional structure of the Ecuadorian *partitocracy*. In the words of President Correa (2009), the Citizen’s Revolution has the objective of generating radical and profound changes in the current institutional structures.

The project is framed in a new paradigm of economic, social and political organization, based on 21st century Socialism. According to Correa (2009), the process and economic management have to be guided by a heterodox line, but with clear Keynesian ideas and without abandoning the market system. The project of the Citizen’s Revolution pursues, through different routes, to generate a profound and transcendental change in the political basis of the Ecuadorian state and a change in the Constitution, so it invokes principles of social equality, sovereignty, and self-determination. The discourse and the political praxis seek to fight for the consolidation of the Citizen’s Revolution, which consists of a radical, profound, and rapid change of all of the current political, economic, and social system of Ecuador.

The factor or initial cause that originated the Citizen's Revolution was the bad quality of life of most of the citizens of Ecuador: poverty, inequality, and social exclusion, without leaving behind the problem of unemployment.

The model defends endogenous industrialization and economic nationalism and, therefore, practices and promotes "a society with a market, not a market society" (Senplades 2013).

The fundamentals or pragmatic pillars of the Citizen's Revolution are:

- The constitutional revolution.
- The fight against corruption.
- The economic revolution.
- An education and health revolution.
- The integration of Latin America.

The previous referents allow us to consider the Ecuadorian model as an economic-political paradigm which appears to rest in the Keynesian current and its political correlate, social democracy, and for that, within the economic theory, the scheme is in a middle ground between capitalism with great participation of the state and little market, an aspect that privileges a political tendency of a socialist type, as acknowledged by its pioneers. The equidistant model of the leftist-rightist political practice facilitates a more inclusive democracy with a strong ideological bias founded in the third way proposed by Giddens (1999) and followed by Blair & Santos (1998) in England, the economy must be ruled by the principle of "markets where possible and state where necessary," Blair & Santos (1998).

In accordance with social democratic thought, "social democracy assumes the commitment of fighting in the political, economic and social arenas, so as to shape and transform the interests of capital and state with a balanced package between market economy and the state of well-being based on clear political rules" (Held, 2006).

The third way, in addition, constitutes a response to neoconservatism-neoliberalism and seeks to delve into democracy through a new relation between the state and the market with civil society, through public expenditure and an ecological consciousness. For this reason, and in accordance with the previously mentioned principles, the Ecuadorian way promotes a Keynesian statism without wild capitalism, where the state is the head of equality and social justice.

The project of the Citizen's Revolution and 21st century Socialism are permeated by the ideology and some practices of neopopulism, which are complementary to the ideology and the politics of the third way or, at least, contribute to fulfilling its objectives.

The economic, social and political crises of the last decades of the 20th century in Latin America were the breeding ground for the pursuit of institutional change, new experiments and governmental modalities, and economic management through some diffuse ideological

positions that today are called neopopulism. This was the case of certain nations in South America, such as Venezuela, Bolivia and Ecuador.

The current neopopulist response was the product of the crises caused by the putting into force of the “recipes” recommended by the Washington Consensus in the 80s and 90s, which were not efficient in satisfying the diverse demands of the population as regards economic growth, wellbeing, health and education.

At present, the concept of neopopulism is used to describe governments of a clear neostatist and protectionist tendency, which seek to foster changes in the economic, social, and political fields. Neopopulism defends a set of practices and ideas that claim to defend the people, but as it lacks a clear ideology, its thinking is eclectic (Mc Rae, 1974). Neopopulism adopts moralist positions and those of social justice; for that reason, it is a political movement, rightist or leftist, although it is more favorable to invoke premises of the latter, such as the apparent defense of the people and natural resources. It moves away from the market and, in some cases, it goes against economic integration; it favors protectionism and endogenous development.

According to Mauffe (2005), the people support neopopulist ideas when they are let down by traditional politics and feels that the institutions do not represent them (as in the Ecuadorian case). For that reason, in a speech to the people of Ecuador, President Correa uses the concept of partitocracy to put the popular classes against the corrupt traditional, and according to him, mafia-like, parties who usurp the power of the citizens (De la Torre, 2010). In addition, and in accordance with Krauze (2012), populism in Ecuador harasses the rich and threatens their freedom of speech, as is expressed by the owners of the mass media.

Laclau (2013), in *On populist reason*, defends the indefinite reelection of the president, as in Ecuador and Venezuela, because far from being an obstacle, populism represents a guarantee for democracy and is, simply, a way to build politics and democracy. For that reason, several authors claim that the democratic consolidation of Ecuador is conjugated with this ideological position.

From the above, it is possible to draw a first conclusion: based on the ideological and pragmatic Keynesian guidelines and those of social democracy, in addition to certain neopopulist overtones, the current president of Ecuador, Rafael Correa, who is in his third mandate, builds an economic and social model that, up to now, and different from what happens with 21st century Socialism in Venezuela, satisfies the social demands of most of the population in Ecuador and, in the economic field, builds a bridge for greater growth and the modernization of the country, without dividing the population due to political matters.

ECONOMY AND ECONOMIC POLICY

General description

Ecuador is an Andean country with diverse characteristics unique to tropical nations, with all the thermal floors and different climates in the mountains and the coastal zone.

The Republic of Ecuador is the eighth most important economy in Latin America, if the magnitude of its gross domestic product (GDP) is taken into consideration. In 2012, GDP reached 70.836 billion dollars. Its composition is represented by 3 main sectors: primary, with 21.4% participation; secondary, with 25.3%, and the most important due to its size, the service sector, with 58.3%.

The economic structure of Ecuador is not very diversified and depends to a great extent on the production of goods that come from agriculture, mining, and fishing. The typical products of export agriculture are represented by bananas, they are the leading world producer; cocoa, cotton, flowers, several fruits and food crops, which come from the cold areas. The export products that come from mining are oil and minerals. Most of the resources that support the growth and the future industrialization of Ecuador come from this raw material. The south of the country has a fishing subsector which is relatively developed and it represents an important part of the revenue, apart from generating employment. The products of the fishing industry that are exported are: tuna, shrimp, fish flour and other derivatives.

For its part, industry produces light manufacturing and some capital assets; processed products with some aggregated value and relatively intensive labor. Also, the production of equipment and means of transport stand out.

The tertiary sector covers a wide range of services, some of little importance, others related with finances, air and land transport, and shipping.

Ecuador basically exports raw materials, such as oil, its derivatives and mining and agricultural products. Oil is located in the Amazonian region and is the main driver of productive activity, as well as providing the necessary revenue to finance public expenditure. For this reason, the economic growth of the country is highly linked to this natural resource.

The Andean nation has the American dollar as its currency, which is the result of the dollarization policy carried out since 2000. Dollarization was put into practice in the country so as to reduce the extreme inflation that reached 100% in the year mentioned and was part of the great macroeconomic instability that the country went through.

Ecuador has achieved important results in the social sphere: the index of human development, IHD, improved in the last two decades and, at present, it is 83 points, which is quite close to that of developed countries and above the average in Latin America. However, a great part of the indigenous population of the country is considered to be one of the poorest in South America, an aspect for which the latest state policies in the social field focus on public expenditure with the aim of stimulating inclusive economic growth, with social progress, justice and equality (Escribano, 2012), apart from material achievements.

Table 2. General information about Ecuador 2012

Population	15,520,973 inhabitants
Currency	\$USD, dollar

Gross Domestic Product, GDP	\$USD, 70,836 billion
Per capita product	\$USD, 8,845, Product Per
Economic growth 2013	Annun 4.0%
Productive structure 2013	
Primary sector	Participation 21.4 %
Secondary sector	Participation 25.3 %
Services sector	Participation 58.3 %

Source: World Trade Organization, Banco Central del Ecuador, MinCit Colombia.

The external sector tried the recipes of the IMF regarding economic opening and fiscal adjustment. The policies recommended by the World Bank and the IMF which were put into practice did not achieve the expected results in the 80s, and for that reason, the country had its turning point with regard to economic policy in 2007, with the election of the current president, Rafael Correa.

Inflation and dollarization

In the year 2000, inflation in Ecuador reached a peak of 100% (see Figure 1), and so the increase in the price of goods and services affected the most vulnerable social groups of the population, for several reasons: the increase in price erodes income and purchasing power; the social fiscal expenditure is reduced and the formation of human capital is jeopardized; consumption decreased, which affected the aggregate demand and the national revenue, aspects that impoverished the population of Ecuador even more and generated macroeconomic instability. Due to all this, poverty in Ecuador went from 34% in 1995 to 46% in 1998 and 56% by the end of the century.

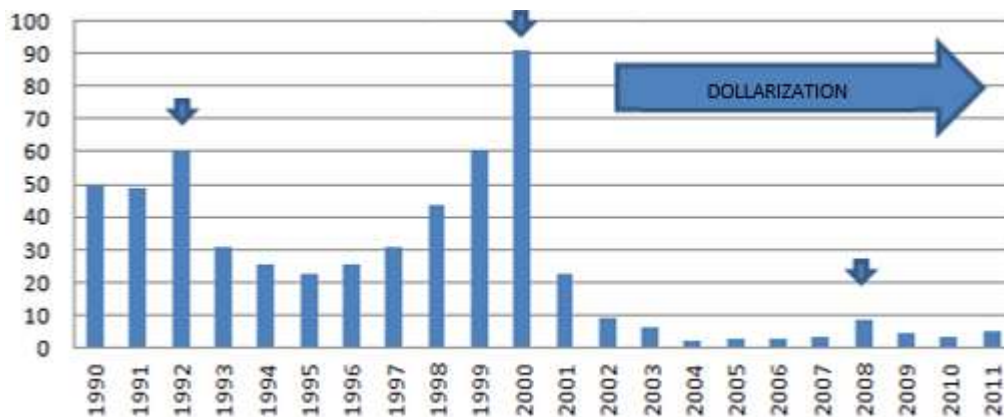


Figure 1. Inflation in Ecuador 1990–2011

Source: Banco Central del Ecuador, National Institute of Statistics.

The dollarization strategy imposed in Ecuador at the beginning of the year 2000 proved to be a successful tool. In recent research carried out by Edwards and Reinhert (2001) and (2003), an

important connection was found between dollarization and the reduction of inflation in various countries which put it into practice, different from what happened in the remaining countries, which followed an independent orthodox policy. For that matter, Calvo and Reinhert (2003) as well as Harberger (2005) recommend dollarization in order to promote macroeconomic stability, both internal and external, and to product growth.

The dollarization of 2000 promoted a mechanism of transition similar to the policy of control of monetary aggregates, this means, it contributed to reducing the interest rate, which had important effects on consumption, private investment and, in addition, it generated a positive dynamic within the financial sector, as a strategy of quantitative easing, the objective of which was to facilitate credit, consumption and, in this way, promote the growth of general scale production. A better climate for investment, as the one obtained as from 2000 with dollarization, paved the way for greater macroeconomic stability, an essential pre-requisite for short and medium term growth, as has been evident in the Ecuador of the last 25 years.

As it was previously mentioned, Ecuador adopted the dollar as its national currency in order to perform all its economic and financial transactions and, for that reason, the dollar became the unit of account and deposit of securities of the population. The dollarization was put into practice during the government of Jamil Mahuad, in March 2000, as a means of reducing the growing inflation, facilitating macroeconomic stability and avoiding the total loss of trust of the Ecuadorian people in the economic policy of the government and, in addition, due to the inability of the Banco Central del Ecuador to face the speculative attacks against the national currency, the *sucre*. On the mentioned date, the nominal exchange rate sucre-dollar reached 25,000 sucre per dollar, as a result of increasing devaluation which managed to make imported essential goods more expensive and, also, because of the erosion of the national currency because of the increase in goods and services.

Countries adopt full dollarization when they face high inflation indexes or anchor their prices to another strong currency in order to prevent and face recurring exchange rate crises that attempt against the stability of the economic system (Berg & Barenstein, 2000). Full dollarization brings credibility and discipline from the different economic agents and, in addition, generates an important impact in the objective of reducing prices and stabilizing inflation, reducing interest rates and increasing public and private investment, aspects that favor an adequate environment for growth (Carbaugh, 2009) and social development.

Dollarization also fulfills an important objective in the search for macroeconomic stability, as it reduces transaction costs in in operations of the purchase and sale of goods and services and, on the other hand, contributes to reducing the risks inherent to monetary and exchange rate aspects which, once controlled, reinforce the dynamic of the productive activity in general and, in particular, of the external sector.

Dollarization also constitutes, in theory and in practice, a radical solution for the countries that face problems in the external sector and in the balance of payments, given that it constitutes a variant of a program or goal of a fixed exchange-rate regime (Mishkin, 2008) and it is an efficient mechanism of the central bank so as to execute the monetary and exchange rate policy that fosters exports. However, dollarizing also means establishing a relation of

exchange rate with the country with which the external sector is linked to, in this case the economy of the United States. In this sense, dollarization represents a tight link with the economy and the currency of the country of reference, which can transmit upsurges and hikes of the economic cycles, including recessive problems.

Dollarization has proven to be a successful tool in the control of inflation and that seems to be clear in the case of Ecuador. Researchers such as Edwards, S. and Magdenzo, I. (2001) found an important connection between dollarization and the reduction in the level of prices in different countries that imposed it; different from what happened in others that continued to have an independent monetary policy. For that reason, most economists recommend full dollarization.

In general, central banks and, among them, that of the Republic of Colombia (Banrep) consider that a high level of inflation attempts against the most vulnerable population and, socially speaking, impoverishes the people with low resources and pensioners even more. Therefore, keeping control over inflation means contributing to the improvement of the redistribution of income, avoiding the transfer of wealth from the less favored groups to those of a higher relative income.

Dollarization programs, in line with the remaining economic policy measures, present advantages, but they are not exempt from consequences. Thus, dollarization in Ecuador-which contributed to reducing the 100% inflation in 2000 to 3% at present and that had an influence in private investment through the reduction of interest rates and positively affected the economic growth of the Andean country, reduced unemployment and contributed, along with tax reforms, to improving the collection and revenue of the state in order to finance fiscal expenditure, it also had consequences associated with the loss of the sovereignty of the monetary policy.

The loss of the monopoly in the issuance of currency by the Banco Central del Ecuador meant a reduction in fiscal revenue due to inflation tax. As a consequence, the state was deprived of seigniorage resources and of the alternative of financing its budgetary deficit through debt with the public or the policy of increasing taxes (Blanchard, 2006). On the other hand, according to Berg and Barenstein (2000), central banks, including that of Ecuador, lose the attribute of issuing and designing monetary policy, that is, the capacity to intervene in the interest rate, which through the mechanisms of transmission of monetary policy contribute to fostering economic activity. For that same reason, the role of the central bank is reduced to being a last-resort creditor, without generating effects in the short-term growth.

Finally, dollarization meant not only the loss of autonomy of the central bank in Ecuador, but also the loss of the sovereignty of the Ecuadorian government as regards economic policy. For that matter, President Correa has proposed backing down on dollarization, but he has found resistance from the business sector and the citizenry, who claim that it has contributed to macroeconomic stabilization and growth as a result of the decrease in prices.

Fiscal policy

As from the year 2000, Ecuador started a successful plan of macroeconomic stabilization. One of the pioneering policies was that of the dollarization of the economy, which paved the way for the dynamization of the productive apparatus. Another of the pivots to promote growth in the short term was fiscal policy, which consists of increasing the level of public expenditure, improving tax collection, conditional transfers and subsidies.

The Government of Ecuador acknowledges that the present model of growth, based on the exploitation of natural resources –oil-, is not sustainable in the long term. For the above and based on fiscal measures of a Keynesian (origin), the expansion of public expenditure was proposed and carried out with the aim of increasing the demand of the government and the private sector in order to foster the economic activity in the country, create employment and revenue. According to Fernández, Parejo and Rodríguez (1995), an expansive fiscal policy – tax reduction or expenditure increase- increases aggregate demand, national revenue and employment. Likewise, fiscal policy is a great instrument for macroeconomic stability and to foster growth. Also, a subsidies' policy improves consumption and increases global demand, apart from fostering the demand for investment of the private sector.

According to the theory, fiscal policy may have an influence on the economic model and act, as well, to correct and redirect certain macroeconomic imbalances through discretionary measures of the government which imply positive changes in the productive activity and that act in a counter-cyclical way to reestablish full employment. Fiscal policy, in this case, must be selective and efficient in the allocation of resources, since not all types of expenditure or taxes have the same degree of efficacy nor promote productive activity in the same way.

Tax reforms, for their part, are also an efficient instrument for improving collection and balancing the national budget, as long as they are well designed and meet the objectives of the makers of the economic policy. Efficient tax reforms, such as those of Ecuador, strengthen the public treasury and contribute to the reduction of the negative effects of public debt.

Governmental activity has particular importance in the economic and social life of countries, since the state provides citizen security and administers justice, it also constructs economic and social infrastructure, apart from covering the flaws of the market. Keynes (2006) defends the interventionist policy of the state and affirms that the expansion of public expenditure has multiplying effects in the economy, for which it is very efficient for short-term growth.

In the Keynesian system, aggregate demand has a fundamental role in the determination of national revenue, for the changes in the autonomous elements of expenditure, as well as investment, are key factors that produce changes in the creation of full employment (Froyen, 1997).

From the point of view of the empirical knowledge available, in order to measure the effects of fiscal policy regarding growth, economists such as Easterly and Rebelo (1993) consider that although the fiscal variables are crucial within economic growth, evidence is scarce, due to the different difficulties involved in measuring the variables that are determinants of the increase of national revenue; however, in the empirical models it is clear that expenditure in the provision of the infrastructure of transport has multiplying effects that increase GDP. The

causality between public expenditure and economic growth is positive, although Cottarelli and Jaramillo (2012) maintain that it is complex as a result of the variety and degree of feedback existing between them.

Engen and Skinner (1992) used a growth model that included a sample of 107 countries in the period 1970-1985 in order to determine the effects of public expenditure in the economy. The results showed negative effects between the action of the government and the tax policy. However, there is vast evidence in favor of the relation of these variables with economic growth. We consider that it is not the amount of expenditure, but its quality, which is the determining key of development, understood as the capacity to promote social wellbeing. The same may occur with tax policy, high marginal taxes for private activity are inefficient, as they discourage the demand for investment or the consumption of lasting goods, as in the case of regressive taxes, and also reduce fiscal revenue, which can negatively affect social expenditure.

In Ecuador, fiscal income mostly depends on the volatility of the price of oil in the international market. Oil constitutes the first exportation resource and the primary and essential source of tax revenue. For this matter, and due to the vulnerability of state revenue and expenditure, the government sought to improve the national revenue through tax reforms that reduced evasion and elusion, and allowed for an increase in collection, an objective that has been fulfilled throughout the current presidential mandate.

With regard to public expenditure, the government not only seeks to increase its volume, but also improve its allocation, so the impact on productive activity generates long-term growth with clear evidence in the social field. In order to fulfill these objectives, the government devotes an important number of resources to the construction of economic and social infrastructure, as they are the driver for the transformation of the productive structure and social change. In this sense, after Correa took power in January 2007, the National Development Plan 2007-2010, Plan for the Citizens' Revolution was elaborated. Afterwards, he proposed the National Plan for Well-being 2009-2013. In both programs the axes of growth and development of the country taken into consideration are the following:

- An economic strategy that is inclusive, sustainable and democratic.
- Recover the state so as to facilitate the efficient use of public resources, with the perspective of more state and less market.
- Growth model to promote equality and social justice.
- Endogenous and sustainable development.
- Agile and transparent fiscal policy in order to promote private initiative (solidary economy) and growth from the “bottom up”.
- More productive investment for scientific development which transforms the productive matrix.
- Increase capital or its gross formation, GFK for long-term growth.
- Increase social expenditure in matters of education, health and nutrition, which improve human capital and reduce poverty.

The previous objectives, which appear in the development plans, are achieved as a result of fiscal expansion and the resources of tax reforms which have their grounds in the enlargement of the taxable base, the efficiency of collection and public expenditure, apart from the income from oil.

As can be observed in Figure 3, the increase in the investment in the non-financial public sector for the years 2006-2013 in the fields mentioned has been important and it doubled in the period taken into consideration.

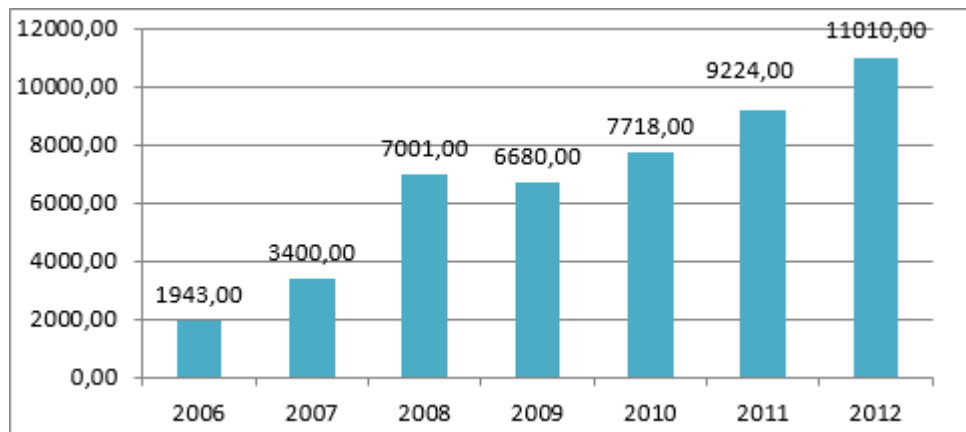


Figure 3. Investment of the public sector 2006-2013
Source: Banco Central del Ecuador, BCE (2013); Senplades.

Fiscal expenditure prior to the presidency of Rafael Correa, in the period 2000-2006, rose to \$USD 47.883 billion, and during the period 2007-2013 of his mandate it reached \$USD 129.277 billion, which means that it grew by 2.7 times. The amount of public expenditure of the second period represents 36% of the GDP, with relation to data of the base year 2007. If, on the contrary, statistics are taken based on the year 2000 of the Banco Central del Ecuador, BCE, in 2011 fiscal expenditure ascends to 4.3% of the GDP, twice the figure from 2006, which reached 23.6% of the national product. According to the ECLAC (2012), Ecuador's fiscal expenditure is the highest in Latin America in relation with the gross domestic product, as can be seen in the following table.

Table 3. Public expenditure in Latin America, as a percentage of the GDP.

YEARS	2011	2012
Latin America	21.9	23.9
Panama	27.0	28.0
Uruguay	21.7	23.1
Chile	21.6	22.3
Paraguay	17.0	22.2
Colombia	18.0	18.6
Peru	16.9	17.8

Source: IMF World Economic Outlook, BCE, United Nations (cited by the Chamber of Commerce of Guayaquil, 2013).

With the data from the previous table, it is easy to infer that Ecuador is one of the countries with more weight in the public sector, in relation to the GDP, since its fiscal expenditure for 2012 equals 30.5% of the GDP and that of Latin America equals 22.9%. This goes hand in hand with the statist model proposed and defended by the current president, with the ideology and the pragmatic outlines of social democracy.

An additional conclusion can be drawn about the results of the public expenditure policy and that is that despite the obvious advancements of Ecuador in the last decade regarding economic and social infrastructure, the model is not very attractive with regard to the results related to growth, since countries such as Panama, Paraguay and even Colombia reached similar or higher figures, despite a lesser participation of the state in economic activity. In addition, the average growth of Ecuador in the period 2000-2006, prior to Correa's mandate, was 4.3%, similar to the period 2007-2012, when it reached the same figure, despite the fact that the fiscal resources available and the price of oil were superior.

Alberto León (2014) agrees with the above. He affirms that the achievements of Ecuador in terms of poverty reduction, access to education and construction of infrastructure are undeniable. However, they mention that Peru and Panama also made their own miracles with which they achieved higher growth rates and reduced poverty even more, without using heterodox models in order to improve fiscal collection, similar to those of Ecuador which, in 2006, expropriated without compensation the assets of the multinational Occidental and collected \$US 3.285 billion, without having to renege on the payment of external debt by considering it "illegal and illegitimate."

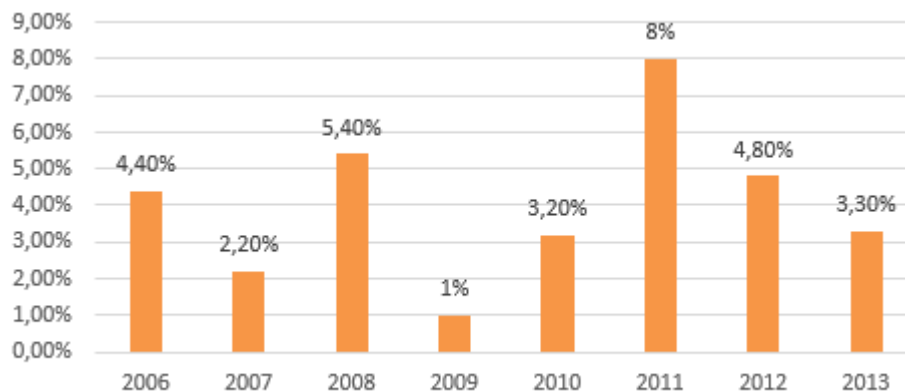


Figure 4. Evolution of GDP in Ecuador.

Source: Banco Central del Ecuador.

It is also necessary to mention that the data regarding growth and public expenditure seem to suggest that the dollarization policy of 2000 contributed to mitigating the financial crisis in

Ecuador and achieving macroeconomic stabilization, but also it facilitated economic growth, thanks to the reduction of inflation, interest rates, the increase in consumption and investment. Finally, aggregate demand and the GDP of Ecuador also increased. It is important to highlight that there is no empirical evidence that confirms this observation. All in all, the effects of dollarization on the increase in the GDP are undeniable.

The increase in public expenditure in the period 2006-2013 was financed with the resources from the increase in revenue in the oil sector, and the increase in tax collection came from the tax reforms which started in 2007. Fiscal revenue increased significantly and became the driver of Ecuador's growth, given that they reached the average figure for Latin America and the tendency even increased despite the international financial crisis of 2009, according to statistical tax data from OCDE for Ecuador.

Fiscal resources mainly come from the tax on consumption, VAT, and the tax on income, and to a smaller extent from the contributions to social security and other derived taxes, such as fees on foreign trade.

The following table shows the comparative tax revenue of the Central National Government (GNC, by its Acronym in Spanish) of Latin America, where Ecuador's fiscal revenue stands out in the period 1994-2009.

Table 4. Fiscal revenue of Latin America of GNC with relation to the GDP.

COUNTRY	1990 - 1994	1994 - 2009
Ecuador	15.5	27.2
Uruguay	25.7	17.2
Brazil	18.2	14.7
Chile	18.4	17.9
Nicaragua	11.0	14.8
Colombia	11.8	11.7
Peru	13.4	13.6
Costa Rica	11.3	14.8
Mexico	13.5	10.8
Venezuela	15.9	13.4
El Salvador	9.8	12.4
Guatemala	7.4	10.3
Argentina	11.6	12.2

Source: International Financial Statistics of the IMF

The total of the public expenditure in the period 2003-2006 escalated to \$USD 47.883 billion with a significant increase in the period 2007-2013, as mentioned earlier.

What does Ecuador spend money on?

The current government seeks to increase public expenditure as well as to improve its quality by doing works of economic and social benefit. To achieve this objective important resources are channeled for the construction of economic and social infrastructure, so they serve as pivots for the transformation of the “productive matrix” and inclusive growth, since the model based on oil is not sustainable in the long term. It is intended to increase the gross formation of capital, GFK, and create the prerequisites for the take-off of the country’s industrialization. Conversely, with the investment in social infrastructure it is intended to improve the supply of human capital, complementary to the physical capital in the proposal of growing and redistributing national revenue in order to achieve development with more democracy.

The extraordinary advancements in economic infrastructure can be seen in the new networks of roads and highways, telecommunications, electricity and airports (Revista Dinero, 2014).

The regional economy makes emphasis on the supply of infrastructure as a means to improve the connectivity of diverse markets and to foster the appearance of agglomeration economies and those of scale that reduce the costs of production and transaction, and have an effect on employment. The construction of road networks reduces the prices of the final goods, which increases their consumption and improves the aggregate demand. Public expenditure on regional infrastructure is also interested in improving telecommunications, the construction of ports, hydroelectric dams, irrigation works, and sanitary and housing infrastructure, all that improves the competitiveness of the country in the international panorama.

Governmental expenditure promotes social change, which contributes to the reduction of poverty and the improvement of collective wellbeing. For this reason, the government of Ecuador destines an important amount of resources to education and health, so that the young population improves their future income, given that health and education increase human capital.

International empirical evidence and the studies carried out by Fan, Hazell and Thorat (2006) show that social investment in education and health in India had a favorable impact in the long term.

The findings made by Mosley, Hudson and Verschoor (2004) confirm said results.

In Ecuador, the construction of modern buildings for primary, secondary and higher education have allowed for the improvement of schooling and the reduction of illiteracy rates, apart from preparing the human resources to face the technological challenges of the current millennium.

CONCLUSIONS

The Ecuador of the times prior to the 21st century was characterized by economic and social inequality, as capital was highly concentrated and the opportunities for the most vulnerable population were almost non-existent, which brought about social unrest. The above, in addition to the economic crisis, inflation and political instability paved the way for the objective of achieving equity, social justice, and economic growth so as to improve the conditions of the least privileged. Thus, the Citizen’s Revolution upsurges and establishes

itself in 2007, with the aim of “refounding the Ecuadorian state and consolidating the social project of building Socialism for Well-being,” which has its grounds in the human being, life and nature.

21st Century Socialism and socialism for well-being puts the human being over capital and makes the state the driver of development in order to build an inclusive, fair and solidary society, according to the principles of a healthy democracy, and places the Ecuadorian citizen as the center of the political and economic focus.

The Citizen’s Revolution was established in the Andean nation in January 2007, and took advantage of and maintained the dollarization program of 2000, which was successful in reducing inflation, consolidating macroeconomic stability and growth.

The decision of dollarizing an economy such as the Ecuadorian one was not exempt from generating unfavorable aspects in monetary and exchange matters. In the monetary aspects, the Banco Central del Ecuador lost its monetary autonomy and gave it to the policy decisions of the Federal Reserve, the FED, an institution that issues and controls the amount of money in circulation in the United States. It also determines the (political) interest rate and controls inflation, aspects that have an influence on the economic growth of the country of origin of the currency as well as in the country that dollarizes. In turn, and in exchange matters, Ecuador no longer has the power to regulate the exchange rate, for it is not its central bank that determines the rates and, for that same reason, it cannot decide to devalue in order to augment its margin of competitiveness in the external sector.

The development plan “Socialism for Well-being”, has its grounds in the magnitude and effectiveness of public expenditure and makes it and the role of the state in the economy, the drivers to re-launch the project of economic and social construction that positions Ecuador towards the industrialization of the current millennium.

The results of the political and social model are materialized in large and modern works of economic infrastructure represented in huge networks of highways and roads, ports, airports and energy and communication programs, which have allowed for Ecuador to improve its competitiveness within the economic international sphere.

For its part, the colossal social expenditure of the model makes emphasis on a more redistributive policy in favor of the poor, and the results are translated into the betterment of the index of human development, the reduction of inequality and poverty, and greater access to education and health.

With the above, an economic and social system was consolidated, more democratic and inclusive, which favored the political stability of the current regime.

However, the current model has an extreme fragility in the long-term, given that it is supported by the prices of the export of natural resources, particularly oil, which is characterized by the great international volatility of its prices. Conversely, the magnitude of

the public expenditure compounds the fiscal deficit and the debt, which may become an explosive load that terminates the growth model.

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