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FROM ECUADORIAN BANKING
CRISIS TO A
NEW ECONOMIC SYSTEM

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I dedicate this monograph to my parents and sister,
specially to my mom,
who has always been there for me,
supporting me and giving me strength to move on,
I know you have been through a lot of pain
to give us everything we need
I love you mom,
you are my inspiration, thank you.
I am who I am because of you.
To my godfather, a great teacher
you were like my grandfather
I wish you could be here,
this is for you.

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SUMMARY

We live in a world where everything depends on money and what people do to make it grow in order to live according to their needs and also to get what they want. I think that the system that is product of how our world is managed is amazing, even in ancient times. Life was based on trade and the relations with it.

Since this world has always attracted me, I have always like Economics, its structure and the center of its study. A part of it is the analysis of banking systems, economic policies of each country and the preventions for potential crisis.

When I was eight years old, our country experienced a time of real economic crisis, I remember it vaguely; later I learnt that it brought us the dollarization, the closing of many banks, and a new structure for the economic management.

Our Ecuadorian crisis is one of the many crises that had so many failures in the structure of its economy as well as in its banking system organization. Most people in our country do not know the reasons that lead us to the deposit freezing and the change of currency, I did not know either, so when the time to choose the topic of my monograph came, I found it interesting to search about our banking failure, finding its causes and solutions.

A banking failure and an economic crisis are the last stage that shows that a country has not managed its resources properly as well as its earnings. By doing my research I found that every economic malfunction around the world follows a pattern or is caused by

many factors that are present before and during the solving of the crisis. We can find that two different countries had fallen into a banking crisis with the same characteristics and way of development, the method each government uses to solve the crisis is what makes an economy to grow or to be worst than before.

According to a study made by the Bank of England, we can learn that the most common causes for a banking crisis are the microeconomic and the macroeconomic circumstances. Inside microeconomics we find that there is lack of supervision with a not well trained staff, that the law for accounts has many deficiencies that do not help to the protection of the client's money; the lack in transparency and the government influence to act in certain way makes possible that a bank gives an account owner the wrong information, stopping him to take actions if he realizes that something is not working properly in the bank's managing. There are other causes inside this subject that are explained in my monograph but I think that the one that has caused us more troubles is fraud and corruption; we have seen how bankers and politicians had run away from Ecuador with our money an sacrifices.

Speaking of macroeconomics we see that many countries do not have a well structured law that supports and protects the system, and that the money the government gets from trade and its managing is poor and it is often expended without an analysis of its consequences to the economy, if it is well invested or not.

Our crisis can be traced back a decade ago, it started with the boom bust phenomenon, oil was found in our Amazon Region and from its selling we got a huge amount of earnings, unfortunately it was not well invested and that money did not

produced more, the government thought that it can afford a debt to improve the quality of life, it was mistaken, and suddenly the income that Ecuador gained from the selling of this resource was designated only to the payment of debts.

Politicians and wealthy people always have had preferences and in this time they used their influences to get loans at really low interests making more instable our economy. Banks also started to offer loans and care few about the trustiness and the credibility of a client; often they could not pay but got money from banks.

A mid crisis appeared in 1996, it could be stopped but no one did anything about it, it did not show drastically, and as a result, it passed without noticing or causing big damages. Our biggest pain emerged in 1998 with the closing of Solbanco, all the weaknesses in our law structure could not prevent and it help to the expansion of the crisis; Filanbanco absorbed troubled and insolvent banks and became a bank with more deficiencies than before, therefore it could not stop its closing.

The last solution seemed to be dollarization, a decision taken with no study and thinking that the strength of this currency would help the economy to stop its decaying and to start its recovering. President Mahuad had to resign after adopting this resolution, at that moment; our currency had lost its value to 25000 sucres per dollar. It is important to remember that our banking crisis came along with our political instability and our irresponsibility when we had to choose our government.

INTRODUCTION

The dictionary defines as an economic crisis the period of economic changes that involves unemployment, increase of inflation percentages, fall of prices and competitiveness in international markets. The government assumes debts in order to avoid a banking failure and withdrawal of deposits attempting to solve the malfunction of the economy and to bring stability back.

Every country enjoys a period of trouble and profits classified into economic cycles. Inside these economic cycles we can find the different stages that a government has to face in order to keep stability and the standard of living of people. The government creates its budget according to the financial conditions of the country. The cycle is made up by three phases:

- Peak: The government has a good balance of trade and gets many profits from investments and production.
- Through: The gap between peak and recession phases; it can be a period of stability, reaching the peak by getting more money from industry or businesses or it can mean a fall into a recession.
- Recession: The most critical stage, the government unemployment rates increase, production decreases, money from industry reduces. This stage is where an economic or banking failure appears, the magnitude of it depends on the management and control of the government.

In History, we all have studied the Great Depression that affected the United States in 1930; it was a huge recession period that caused global damages. The Great Depression came right after the Roaring Twenties, a time in which US had become a global power and the

development of technology gave it big amounts of money, people started to spend all their money, leaving no savings for them, the government acted similar.

Industries did not plan their production, having as a result an overproduction saved in warehouses. The crisis finally broke up when the stock market crashed on October 29, 1929, also known as Black Tuesday, as the economic failure affected a super and industrialized country, the nations that depended on its market suffered almost the same damages.

We can think that nowadays it does not happen anymore, governments have learned about their mistakes or from other's mistakes and manage their economy carefully, if this is our opinion, we are falling into a big error. After the Great Depression or Slum, small countries have suffered banking failures, with many losses in its international markets and getting more debts in order to solve the crisis; our country, Ecuador, is one of them.

I am seventeen years old and I vaguely remember our native currency, Sucre, I remember that when I was a little child I watched in the news that some banks had closed and many people were left without their savings. Suddenly our president Jamil Mahuad was resigning and living us with a green paper as our new currency, we know it as the dollar.

I grew up only knowing this and later I learned that it was the economic crisis of 1999. As the topic of my monograph I chose it because of two reasons, the first one, because few people really know the causes that carried our country to that horrible situation and malfunction. We all know what happened but no why or if we had some guilt in the matter. To avoid a similar crisis is important to be familiar with all of this, to be prepared and to control the management of the country. We vote for our leaders and administrators but it is our right and their duty to keep us informed of their movements and to claim for reports that show us the

finances of the country so we can fight on time for something that does not seem accurate or that does not work for our benefit.

The second reason of my choice was because I plan to study Economics, and I wanted to know if an economic theme would reaffirm my conviction or change it. Since I enjoyed writing this monograph and reading about economics matters, I've become sure that my election of career is the correct one and this is what I want to do.

As well as I loved and liked researching about the Economic Crisis in Ecuador, I hope you will enjoy it the same way I did, and take conscience that any change is not done by one person, it is done by a group of people that want the best for their country.

CHAPTER 1

CAUSES FOR A BANKING CRISIS

This chapter analyses the general causes for a banking crisis in the world, which will be a helpful tool to understand what caused the banking crisis in Ecuador in 1999.

1. Macroeconomic Circumstances

The principal cause of a banking crisis is the macroeconomic instability. The crisis originated by macroeconomic influences obey to factors that are related or connected to: High interest rates, exchange rates falling down, slowdown of the pace of general inflation, banks that surpassed high inflation, later faced problems due to bad management during periods when the inflation was steady or low.

Transitional economies face crisis due to the shift between relative prices and the withdrawal of subsidies creating pressure in some business and activities linked to the banking economy.

The causes above mentioned are the most common in a banking crisis influenced by a macroeconomic condition, other causes can be a monetary squeeze needed for a previously deterioration in the monetary or economic position, which may have been visible.(Mexican crisis of 1994 presented these characteristics); or because political instability or factors.

2. Microeconomic Policies

The factors inside microeconomics causing a banking crisis involve structural and supervisory parameters that are under the governments or central bank's control and influence. These aspects of a banking breakdown are:

2.1. Supervision:

The definition of the roll of supervision in a baking crisis is often misunderstood; it is only cause for a banking failure. If supervision were too rigid in order to avoid any chances of a banking failure, it would make the bank to an uncompetitive business; consequently, it would fail its ultimate function of providing efficient financial intermediation to the economy.

2.2. Inadequate infrastructure in matters of accounting, law, etc :

Inadequate infrastructure in accounting it is not always common but it is the immediate cause of a banking failure. Nevertheless, the weakness in the customer's accounts can be as harmful as the lack on banking operations. Shortcomings in the legal infrastructure may slowdown the exercise of property rights and the achievement of bank loans' guarantees.

2.3. Liberalization / Deregulation:

Deregulation requires attentive supervision to ensure that all the activities are managed prudently. Since it has provoked a huge reaction in the financial sector, it allows banks to work freely by removing the cut back of controlling the banking system.

2.4. Government Interference:

Sometimes the government influences in order to persuade a bank to lend to particular customer with a preferential treatment. The imposition of malicious reserve requirements at a low interest rate or not paid back, are other damaging official acts.

2.5. Moral hazard:

Even though failure is not the goal of every bank, it represents a possibility to land on it if banks do not fulfill the ideas mention above.

Moral hazard refers to prolonging banks survival until they can keep the flow of the depositors' money. In long terms, this process will lead the bank to its failure.

2.6. Lack of transparency:

A bank lacks transparency because of a poor legal structure or other factors such as the culture or the bank's framework of law. Banks falls into lack of transparency when they lie about their financial status to their clients by not giving them all the needed information. This hidden information dulls the market forces to determine a bank's fate.

3. Banking strategies and operations:

Many of the banks' problems are due to the deficiency of their strategy or their operational failure. Supervisors must take into consideration responsibility because of their acceptance of

strategies, which will be known as poor or brilliant after an event. In a market economy is open to discussion whether the supervisors should interfere. The most common reasons are:

- Mistaken or too rapid investment into new areas of production
- Malfunction of development of a new management ideology in order to operate effectively.

Economists have established the following types of operational failures:

3.1. Poor credit assessment:

A related failure is the credit selection; banks often deny credit to cautious customers and provide credit to the ones who want to take longer periods of payment at higher interest rates. Poor credit assessment is commonly linked to the macroeconomic circumstances that have been mentioned at the beginning of this chapter.

3.2. Interest rates or exchange rate exposures:

To avoid losses they have to be limited to a supervisory control. Changes in the macroeconomic policies could incite changes in the limits established.

3.3. Concentration of lending, and connected lending:

As in interest rates, loans ought to have supervision and control. In many countries, individual banks have high links with particular customers or economic sectors. This

connection often leads to troubles. In developed countries, ceilings on loans are clearly specified and enforced.

3.4. Unauthorized trading or position taking:

It might have become an progressively more worrying source of bank losses or in subsidiary companies, in every case of a bank breakdown a single individual is responsible for the failure.

3.5. Other operational failures:

- *“Poor quality of staff, or low experience, as a result of high staff turn over or too rapid expansion of business;*
- *Deficient management structure with insufficiently clear lines of oversight and responsibility;*
- *Inability or reluctance to control costs;*
- *Reward structure for staff that encourages excessive risk-taking;*
- *Inadequate documentation, recording and audit trails;*
- *Over-reliance on IT systems, without adequate back-up, without sufficient trialling and verification, without proper audit arrangements, or without management understanding enough about the systems;*
- *Absence of contingency plans to deal with either external or internal emergencies¹.”*

4. Fraud and Corruption:

Fraud and corruption is caused by particular traders or dealers, the consequence of this is the corruption in the management in a financial organization. Employees and customers can be vulnerable to commit a fraud in cooperation with today's technology.

¹ LATTER, Tony, *Causes and Management of Banking Crisis*, <http://www.bankofengland.co.uk/education/ccbs/handbooks/pdf/ccbshb12.pdf>, p. 26, access: November 17th, 2007, 21h54.

The worldwide main causes of banking crisis have been analysed by English Bank, which are the same that took place back in Ecuador back in 1999 that carried many banks to failure. These causes have been changing as time goes by, nevertheless, some of them still remain in the world and may not ever change specially in third world countries such as ours.

CHAPTER 2

CAUSES FOR ECUADORIAN'S BANKING CRISIS

On the previous chapter we analyzed that the main causes of banking crisis are: supervision, liberalization/deregulation, government interference, moral hazard, lack of transparency, interest rates or exchange rates exposure, concentration of lending and connected lending, fraud and corruption, among others.

An economic crisis is built along time. Our banking failure of 1998 can be traced ten years ago and can be explained in three main areas

- The failure of implanting a good regulatory and supervisory environment during financial liberalization. It refers to the microeconomic bases of the crisis.
- The boom bust phenomenon during 1993 to 1996, leading to the macroeconomic circumstances of the crisis.
- The financial problem during 1997 and 1998 was due to the lack of fiscal policy and failure of introducing reforms in the financial sector.

1. Financial Liberalization with Lags in Institutional Building

Financial liberalization intensified in Ecuador in the early 1990s, involved the domestic financial markets because of the allowance of free movement of private capital. Interest rates began to be determined by the market in 1993. A fusion between foreign exchange market and national market was achieved in the second half of 1993; as the level of unremunerated legal reserve was reduced during 1992 to 1994. Finally, in 1994 a big step for bank modernization

was done, the passing of a law “Ley General de Instituciones del Sistema Financiero” (LGISF) tried to regulate the legal framework of the financial system.

This law contained the operations that a bank was allowed to perform. The law introduced the bank holding company that would help the supervision of financial corporations. The law was not well structured; it did not follow any banking model and it authorized banks to take higher risks by minimum capital requirements, loan classification and provisioning rules. Along with the law, financial societies were created, in order to work together with banks but could not demand deposits.

Financial liberalization in Ecuador was needed in order to succeed in the modernization process. The financial system had become incompatible with capital mobility, deregulation, financial innovation and technological development affecting the country’s economy.

Liberalization began to be a problem for Ecuador due to the execution of LGISF through regulation, supervision, and enforcement of law did not turn up fast enough to prevent a collapse in the banking system and the legal framework of the law had many deficiencies.

Along with liberalization three problems showed up and made our economy more susceptible to suffer damages:

- Failure to apply supervision to financial institutions especially to offshore banks and investment funds.
- Deficiencies in the structure for troubled bank resolution.

- The propagation of mediators with low capital.

1.1. Consolidated supervision failures

Banks controlled the Ecuadorian financial system which included onshore, offshore, fund management company, securities trading/brokerage house, credit card company, leasing and factoring businesses and insurance companies. The LGISF intention was to apply supervision to these institutions, unfortunately the crisis of 1998 emerged before the implementation of this law was possible. The absence of supervision made possible through the corrupt managers and stockholders to over the bankruptcies due to robberies.

1.2. Deficiencies in the framework for bank failure resolution

Weaknesses appeared during financial liberalization because LGISF did not establish a proper framework to avoid bank failure, corruption during bank closing and to stop the run of deposits during troubled times. Banks could not close during crisis; only the small ones were permitted to do so. The fear was that the failure of the biggest banks would go together with prolonged delays in the payment to depositors and it would affect similar banks.

LGISF did not offer alternatives to solve the collapse in the financial system. For instance, La Superintendencia de Bancos² had no power to interfere during the crisis of any bank. Because of this LGISF law, the malfunction of the bank had to be detected promptly by managers and supervisors to avoid insolvency, exposing bank shareholders and depositors to risk of loss. According to the law, this system would improve market discipline and maintain moral hazard ensured.

² It supervises the banking transactions in Ecuador.

“Legal deficiencies in bank intervention, closure, and resolution deprived Ecuador of an essential pillar to ensure the soundness of its banking system in the midst of financial liberalization”³ ⁴.

The Central Bank had to provide solvency to a bank until La Superintendencia de Bancos declare it insolvent. The lack of the adequate framework to solve bank problems made the crisis to grow and to explode.

1.3. Too many intermediates with low capital

The spread of financial entities in a small market as ours made more vulnerable our economy. No matter if financial institutions had the right amount of capital to operate; they could perform all the functions of a regular bank. The overpopulation of financial institutions brought up new and complex risks that could not be controlled because of the lack of training of the personal employees and supervisors in older and in newer banks.

1.4. Financial liberalization in the context of oligarchic power structures

One of the biggest causes for our economic crisis was the political power of some sectors that used their influence to gain or defend economic privileges.

Most of the economy in our country was ruled by families who owned many important businesses in non financial sectors and had strong political connections. Banks were often used as a mean to give out political favors. Supervisory authorities could not do

³DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf), p. 6, access: December, 8th, 2007, 22h25

⁴ Perry, Burki, et al. (1998), Chapter 3, makes the case that banking system soundness and the functionality of the safety net crucially depend on three, mutually reinforcing pillars: capital, monitoring, and exit.

anything regarding political influences in the financial system; they felt afraid of what “important people” could do to them. The oligarchic power made impossible to control and to manage a future crisis.

2. Capital inflows, credit boom and sudden stop (1993-1996)

This phenomenon demonstrated by capital flow and domestic credit provided more of a macroeconomic interpretation of the financial crisis in Ecuador. The sudden stop of credit and capital flow exposed the weaknesses in a dramatic way, even though the consequences of this sudden stop were controlled quite fast.

2.1. The surge in capital inflows and domestic credit (1993-1994)

Since Ecuador joined the rising markets in 1992, the country received important flows of capital which led to a lending boom. The reasons for this capital flow and the credit boom can be explained by pull and push factors.

The pull factor was the triumphant macroeconomic stabilization program with which the stability of the nominal exchange rate made the inflation rates go down.

Push factors were international liquidity and unpleasant investment opportunities in developed countries because of the lower interest rates in the United States. The situation in Ecuador, referring to credit boom clearly states that a credit boom precedes a banking crisis. The excitement of the boom improved information problems, resulting in an underestimation of the nature and extent of risks taken by financial intermediates.

2.2. Sudden Stop

The credit boom had to have an end; the risks were growing higher for the Ecuadorian economy, bankers realized that the lending capacity they thought they had brought to their systems many risks and failures. The depreciation of our currency started to be seen by the financial sector.

“Dominant were major Ecuador-specific shocks whose effects were compounded by a general deterioration of the external financial environment associated with the Mexican crisis of 1994-1995. Latin America as a whole was experiencing a slump of capital inflows but Ecuador’s fate was much worse”⁵

Accompanied with Ecuador’s inflow of capital, the country was going through a military conflict with Peru, which produced big damages for our currency: Sucre. Authorities defended the currency expecting that the battle would last few days, and it lasted six weeks affecting the interest and liquidity squeeze.

After a partial solving of the crisis after the resolution of the military conflict, political instability showed up, PSC forced vice president of the Republic, Alberto Dahik, to resigned. Abdala B. was elected president of Ecuador in 1996 but never showed honesty during his mandate. Therefore, Ecuador had at the time high interest rates. The Central Bank did not succeed on relieving the pressures on interest rates increasing the rate of currency losing its value. Inflation was higher.

2.3. Banking system distress in late-1995 and early-1996

⁵ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf), p. 11, access: December, 9th, 2007, 11h41

A medium-intensity crisis in 1995 affected financial societies and a few small banks. The crisis consisted in illiquidity affecting the most vulnerable entities; the economic was hurt also by the failure of two brokerage houses.

“Depositors responded to the financial system distress mainly by moving from financial intermediaries perceived as weak to banks perceived as strong; they did not massively move out of the banking system as a whole”⁶

Seventeen financial institutions had to close their doors due to inflation and their own failure with the exception of the banking system which was still solvent.

3. Post-Crisis Inaction or a Wasted Opportunity (1997-98)

Banks did not suffer much of the crisis but the internal risk system was not reinforced. Therefore, a bank failure was being delayed until its riskier point. This inadequate action hurt Ecuador’s economy. The solution for the middle crisis had to be applied, but no actions were taken due to the political instability and failure of the legal system. Banks become weak and start to lose its financial capacity. Supervision and regularization was absent in the taking of decisions to resolve the crisis. Macroeconomics became vulnerable and the government started to borrow from international markets. By then, the crisis had reached its riskiest and highest point.

CHAPTER 3

ECUADORIAN’S BANKING CRISIS

⁶ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf), p. 13, access: December, 9th, 2007, 12h06

The previous chapter analyzed the reasons that led to our country to its crisis in 1998 and in 1999. This chapter shows how these causes affected Ecuador's economy and brought us to a time of trouble and instability.

1. Crisis Eruption and Containment Efforts

By the second half of 1998 the Ecuadorian financial system went through a crisis of confidence that precipitated the run of deposits and the depreciation of the Sucre. Numerous incidents hurt Ecuadorian economy: confidence collapsed, and banking and exchange rate crisis erupted.

1.1. Depositors Anxiety, Shocks, and Liquidity Squeeze

The twin crisis (banking and exchange rate) spread out with the growing of depositor anxiety, external shocks, and a major liquidity squeeze.

Depositor anxiety appeared in 1998, two major events made this possible:

- The closing of a mid-size bank, Solbanco, it happened in April 1998 and due to the claims of the depositors it reopened in October of the same year, this episode provoked Banco del Progreso to have a huge deposit run in May 1998.

“And given the absence of limited deposit insurance, creditors of the reopened Solbanco remained skittish, wondering about the value and ultimate recoverability of their deposits.”⁷

⁷ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*,

- The second event was the closure of Banco de Préstamos, a bank in size like Solbanco, in August 1998. The closing caused instant losses on its depositors and led to the collapse of payment to the bank's inter-bank and trade lines. International lines moved away from the Ecuadorian banking system and deposits were removed from big banks also, banks like Filanbanco and Banco del Pacífico.

External phenomena also affected Ecuador in 1998:

- El Niño had an effect on agriculture, commercialization and physical structure of the Coast, it worsened the decay in the quality of banks' loan capacity;
- The drop of the oil price shocked public finances; a fiscal crisis came along with the financial crisis.
- The third problem was the contagion from the Russian debt default in the Fall of 1998; it caused a sudden drying up/reversal of external finance, the increase of interest rates, and currency devaluations in Latin America, hurting Ecuador specially.

All of these events together incited Ecuador's liquidity squeeze. "The stock of international credit to the Ecuadorian banking system fell by US\$ 500 million (2.6 percent of 1998 GDP) between July 1998 and March 1999 and the accumulated outflow of non-FDI private capital during the last quarter of 1998 and first quarter of 1999 is estimated at US\$854 million (4.3 percent of 1998 GDP). The consequent liquidity squeeze prompted the weakest banks to intensify their distressed borrowing (i.e., gathering deposits at very high interest rates), led to mounting pressures on the exchange and interest rates, and pushed the BCE to fully open its lender of last resort (LOLR) facilities.

About 17 banks (out of 35), representing some 60 percent of the system, were chronically or acutely illiquid by October 1998. Around the same time, 11 banks, representing about 25 percent of the system and including Filanbanco, the largest bank in terms of assets, were receiving emergency liquidity from the BCE. Off-site estimates performed during October 1998, including by a World Bank technical assistance mission, suggested that the deficit in provisions was possibly as large as the system's book value of capital, and that it was mainly concentrated in the two largest banks in the country—Filanbanco and Banco del Progreso⁸

1.2. Policy Makers against the Ropes.

By the Fall of 1998 the capacity to plan and to restructure policies reduced dramatically and a good policy response was very difficult considering the financial crisis that affected the country.

At the beginning of Jamil Mahuad's mandate there were several probabilities and hope that the crisis could be controlled and solved, therefore it was necessary to establish new policies that retained the capital flow and deposit run, having as a result the stop of the confidence crisis.

The solutions came too late and the elimination of the income tax in December of 1998 (because of a political compromise) provoked the help of the International Monetary Fund (IMF) go away from our country. Ecuador had to hold its crisis by itself.

The Central Bank could not assist banks in its solvency or in its deposits, higher interest rates made the financial system to decline dramatically and the currency was devaluated more and more.

⁸ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf), p. 17, access: January, 2nd, 2008, 21h07

The Central Bank faced the dilemma between protecting the banking system through supplying liquidity versus protecting the currency through liquidity tightening

Liability dollarization came with the fear of having an exchange rate too high that could not prevent and solve banking and financial failure, the dollarization process among Latin and other world countries had been growing since 1994 and reached its higher point in 1996-1998.

“Regulators required banks to broadly match dollar assets and liabilities, but banks were not required to constitute provisions for dollar lending to domestic residents with no dollar earnings. Thus, unhedged exposure to exchange rate risk among household and corporate debtors implied a significant unhedged exposure to credit risk for banks. Liability dollarization became a significant structural feature of the Ecuadorian financial landscape in the second half of the 1990s, and it seriously constrained the room for exchange rate policy maneuver.”⁹

“La Superintendencia de Bancos” was worry about the solvency of two major banks, Filanbanco and Banco del Pacífico but analysts and financial studies showed that the banks were far away from a banking failure.

As an emergency act, a Deposit Guarantee Agency (AGD) was created with many deficiencies in its legal structure; its role was to take care of deposits and to provide the solution for a banking crisis. The AGD law came with many moral hazard doubts and a lack of trust among depositors, the fear was that in some moment the government could use the money of the accounts to support the crisis.

⁹ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf), p. 17, access: January, 3rd 2008, 21h09

2. Exchange rate crisis and banking system disarray

BCE's strategy of higher interest rates failed, the percentage was unbearable for Ecuadorians, "the overnight interest rate peaked at 170 percent by mid-January 1999 and remained in the 100-130 percent range through early February."¹⁰ The central bank had to sell dollars in the foreign exchange market to keep the Sucre within the exchange rate band. The sales were made in order to keep the liquidity among banks and in an attempt of solving a really hard situation.

By the end of 1998, beginning of 1999 the confidence crisis had become much bigger and the deposit run could not be stopped and grew with intensity. With no hope in the IMF help and no solutions left, the BCE let the exchange rate go high and freely and in February 12th of 1999 gave up the exchange rate regime and allowed the Sucre to lose its value in the international market without restraint. Soon the Sucre went to 7 000 to 18 000 per dollar in two weeks, ending March 5th of 1999.

This policy of the BCE was holding many financial institutions; with the Sucre being devaluated with no restriction the situation for them was not easy. Filanbanco stayed opened and changed of authorities as the AGD ordered, the idea was that the bank remained open waiting for reprivatization and recapitalization; 5 banks, 2 financial companies, 1 credit union were closed after Filanbanco's crisis. As the actions were of the knowledge of all people, the confidence crisis became harder and worst through time.

3. Behind the failure of Market- Based Containmentment

¹⁰ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf), p.22, access: January, 3rd 2008, 21h28

“The challenge was to reverse the flight out of the Ecuadorian financial system and turn it into a flight to quality within the system. As this was not achieved, the possibility of an orderly bank restructuring and resolution process—to root out insolvency—disappeared. Ecuador is, in fact, a salient case in the Latin American region where the continued bleeding of liquidity out of the banking system rendered virtually impracticable the execution of orderly bank interventions and closures.”¹¹

People had no trust on the system and in the guarantee of their deposits, the confidence on the government was lost as well; the reason reclines on the following factors:

3.1. Coordination failures

Coordination failures were a consequence of institutional weaknesses and conflicts between policy makers. The Ministry of Finance was unwilling to issue bonds at market related conditions to support AGD decisions in banking matters. Thereby, the AGD authorities felt uncomfortable about closing a bank or declaring it in crisis, they thought it was too risky economically and politically speaking.

Political confrontation and misunderstanding among the government and the Minister of Finance and the General Manager of the BCE with the President of the Republic made tensions and instability to grow.

¹¹ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf), p.23, access: January, 3rd 2008, 22h18

The disagreement was more evident when the BCE stated that the solution for the crisis was to declare insolvents the banks that were trying to survive and to defend the liquid ones, Superintendencia de Bancos opposed arguing that it was too risky and a financial study was not prepared. At last, with no decision taken, the banking holiday with the deposit freeze arrived, the General Manager and many members of the BCE Board quitted.

3.2. Deficiencies in Administrative Capacity

The Superintendencia de Bancos could not advice and give a good assessment to troubled banks and it made difficult for the institution to establish whether a bank was solvent or not. To lower the crisis the best solution was to move the deposits of a closed bank to a healthy bank, but as the bank was declared insolvent and in bank rapt the deposits were frozen and the depositors did not know when they could have them back.

4. Deposit Freeze

“The unraveling of containment efforts that preserved investor freedom led to forcible and intrusive containment, materialized first in a one-week bank holiday (March 8-12, 1999) followed by a freeze on deposits (starting on March 15th). Important triggers for such extreme measures included: (i) the seemingly uncontrollable depreciation of the currency; (ii) the apparently insatiable demand for BCE liquidity by ailing banks; (iii) the risk of financial contagion due to the imminent failure of Banco del Progreso; and, (iv) the perception of adverse political repercussions of the closure of that bank in the midst of rampant regionalist tensions.”^{12 13}

¹² DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf), p.26, access: January, 3rd 2008, 23h03

¹³ Some policy makers of the time add another trigger to this list, namely the rapid decline in the stock coins and bills in the BCE, fostered by the 1 percent tax (Section III.C above). In addition, social unrest was high—in the days where the bank holiday decision was taken, the capital city was virtually paralyzed by a taxi-driver strike.

The freezing of deposits had been prevented if the insolvent banks had been closed in the bank holiday as the Central Bank affirmed; this key to solve the crisis probably had acted effectively avoiding the troubles that came with the freezing of bank deposits. The decision made all people think that all banks were insolvent and with no money to operate. “The deposit freeze was accompanied by an automatic reprogramming of bank loans, so that loan payments would not fall for a year, until deposits were fully defrosted. By end-July 1999, the equivalent of US\$3.7 billion were frozen, that is, 58 percent of a total of US\$6.4 billion of deposits in the extended (onshore and offshore) Ecuadorian banking system. The frozen deposits were about equally distributed between the offshore and the onshore segments of the system. And they were predominantly dollar-denominated”¹⁴

This chapter make us understand better our crisis, the following part will go deeper in the banking failure and will explain and remember the worst part of it, being followed for what seemed the only way to get out, the dollarization, how it was implanted and how we made through the banking malfunction up today.

¹⁴ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf), p.27, access: January, 3rd 2008, 23h10

CHAPTER 4

THE DEPTHS OF THE CRISIS

The year 1999 marked our country tremendously, it was the time where the crisis worsened and the economic harm for the state and the people was unbearable. The third chapter analyzed how the deposit freeze, the low prices of exporting oil, and the idea to restructure the banking system in the country led us to the most awful part of the crisis.

In August 1999, the depreciation of our currency was going higher; the Sucre went to 10.000 per dollar to 26.000. The strong monetary policies that the BCE passed in an effort to control and reestablish the banking failure made the malfunction of the economic system to collapse in a harder way.

“The currency fall appears to have been exacerbated, rather than mitigated, by a major tightening of monetary policy engineered by the BCE in late-1999, which led to a skyrocketing of the inter-bank interest rate from the 50-60 percent level registered during May-November 1999 to 150 percent by the end of the year. Most troublesome was the free fall in the real exchange rate. It depreciated by 63 percent from August 1999 to January 2000 (and by 108 percent during the 15 months ending January 2000). The combined effect of the freeze and the runaway depreciation of the real exchange rate led to a massive turnaround in the external current account, from a deficit of 11 percent of GDP in 1998 to a surplus of 7 percent of GDP in 1999—a swing of 18 percentage points of GDP (!), 66 percent of which is attributable to a collapse in investment and the remainder to a compression of consumption. And real GDP shank by over 8 percent in the second half of 1999 (compared to the same period the year earlier).”¹⁵¹⁶

¹⁵ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Finacial%20Crisis%20compiled.pdf](http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Finacial%20Crisis%20compiled.pdf), p. 28, access: January, 27th, 2008, 10h19

¹⁶ The deterioration of economic conditions generated a massive out migration of workers, who entered industrialized countries illegally (USA and Spain mainly). The net out migration in 1999-2000 is estimated of about 650.000 people (5% of the entire population).

1. International Audits:

A program of audits for the Ecuadorian banks was held during May to August of 1999, it was part of a strategy to restructure the banking system, and the tactic was designed with technical assistance of multilateral agencies¹⁷. The audits were performed by international agencies such as Price Waterhouse, KPMG, and Arthur Andersen, their goal was to establish the solvency level of each bank (credit risks were evaluated). A team of foreign advisors were part of an Evaluation Unit that supervised the process; their role was to evaluate the results of individual bank audits, made fit in them accounting adjustments, and classified the banks into categories:

- Category A: Capital Compliant Banks, would remain under the control of their private shareholders and managers;
- Category B: Capital Deficient Banks, would be placed under a tightly recapitalization process, it helped capitalization from the private sector; and,
- Category C: Insolvent Banks would be placed under the control of the AGD awaiting for a resolution.

The auditing process was well managed; it worked effectively considering the resistance of the Superintendencia de Bancos to declare some banks insolvent. The deposit freeze forced some stability to the economic system by avoiding the increase of deposit run.

¹⁷ See IMF (2000), pp. 23-34 for a description and assessment of the Restructuring Strategy. The strategy envisaged actions in three main fronts: (i) the control and management of systemic liquidity in the short-term (including a chronogram for a gradual unfreeze of deposits, a tightening monetary policy, and efforts to make the deposit guarantee credible) ; (ii) banking crisis management (including, prominently, the international audits); and (iii) the strengthening of the regulatory and incentive framework in the medium term (which included, later on, in 2000, a strategy for corporate and household debt restructuring).

The presence of multilateral agencies, international auditing firms, and foreign advisors protected political interference; therefore, the audits that were taking place brought a certain sense of transparency and truthfulness in financial reports. However, this feeling of honesty did not bring the confidence back into the system and could not prevent new attacks on the currency and the banking structure.

The auditing process confirmed the institutional failure of the Superintendencia de Bancos, it was well known that the institution was unwilling and incompetent to perform its role. Consequently, the people started to fear the system and the government that seemed that could not protect the people from the crisis and to take the country out of the banking failure. As a response to the situation, citizens trusted and felt more comfortable in any unfrozen financial institution that helped them to escape from the Sucre and the banks.

Because audits take time people became impatient with the pass of the days, they could not use or withdraw their deposits and had to wait for the fate of their banks, whether to know if they were solvent or not.

The final information from the audits were presented in July, they confirmed the fears of the depositors, five of the larger banks were in the list of the institutions that had financial instability, Banco del Progreso had to close immediately after been declared insolvent, Pacifico, Previsora and Popular Banks were capital deficient. Filanbanco provided loans to banks that needed capital; also it absorbed Previsora, making itself a more troubled bank that before.

2. Sovereign Debt Default:

“Public sector indebtedness was rising rapidly with the issuance of AGD bonds to deal with the banking crisis, GDP was falling, and cash constraints had forced the government to fall increasingly behind in its non-debt obligations, including wage payments to civil servants.”¹⁸

As a result of the crisis, Ecuador’s image in international markets was not good causing real damage in foreign trades. The country needed to borrow money in order to support and resolve the crisis but as it got worst with time, Ecuador started to be late in the payments and no outside bank wanted to lend money, the country needed the support of the International Monetary Fund, but it did not changed of position and did not wanted to help as Ecuador did not wanted to get to an agreement with the private sector of the nation.

“In short, Ecuador’s default on its internationally-traded bonds was an important contributing factor to the post-August 1999 speculative attacks on the Sucre and the banks controlled by the public sector. In particular, it helps explain the runs on the two large (“capital deficient”) banks—Previsora and Popular—that prompted their takeover by the AGD scarcely a month after the announcement of the international audits.”¹⁹

¹⁸ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Finacial%20Crisis%20compiled.pdf](http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Finacial%20Crisis%20compiled.pdf), p. 31, access: January, 27th, 2008, 13h49

¹⁹ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Finacial%20Crisis%20compiled.pdf](http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Finacial%20Crisis%20compiled.pdf), p. 33, access: January, 27th, 2008, 14h00

3. The Devaluation Insolvency Spiral

“The fall into the depths of financial disarray during 1999 featured a seemingly unstoppable depreciation of the real exchange rate, a consequent dilution of dollar GDP, and rising insolvency for the banking system, households, corporations, and the government”²⁰

Many Economists think that the motive for a currency to be devaluated is product of the fast growth of one country’s economy. This was not the case of Ecuador, it had a good economy that supported its system but not the best that it ever had. The devaluation was due to the minor crises that were never controlled and appeared with tremendous force.

As seen before, providing liquidity to banks by the BCE caused the Sucre to loose its value more quickly. The only way to stop the devaluation of our currency, the country having more problems in financial markets, and the increase of the amount of its debts was adopting a more powerful currency, the dollar.

4. Dollarization:

Dollarization was announced by President Mahuad in January 2000. From that point forward, the BCE ceased to print sucres; it only sold (in exchange for money base) as much dollars as demanded at the conversion rate of 25,000 sucres per dollar. Dollarization legally entered into effect only in March 2000, with the approval of the respective law, and after President Mahuad was replaced by President Gustavo Noboa.

²⁰ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf), p. 33, access: January, 27th, 2008, 14h02

Dollarization finished at once the devaluation situation and the insolvency problem, which seemed impossible because of the many policies and restructures that, had been done to the system until that moment. Depositors felt much secure with the dollar adopted.

It was lucky that the dollarization did not caused more harm to our damaged economy, it was approved without any study and with no thinking, it was a decision taking in the moment as a way to get out of the bad times that the country was going through.

The law that was passed in order to keep dollarization had not a fundament or previous study; it was done to expect a favorable change in the economy. Dollarization represented a huge change for the labor areas.

As amazing it may seemed, the conditions of the country were getting better, the price of oil started to rise, the IMF signed an agreement in which it compromised to help Ecuador as well Ecuador reestablished relationships with its creditors, a way of payment for the country was accepted.

The run of deposits was stopped, the confidence crisis too, and the GDP began to grow high, economic stability was coming back to the nation.

5. Inflation Hump and Dilution of Debt:

Before having an inflation stability, it was important with dollarization to change prices from Sucre to dollar, the costs of things had to be converted to the last rate in which Sucre had loose its worth, 25 000 Sucres per dollar. Ecuadorians felt uncomfortable, they were expecting

a quick solution for the crisis but they did not realize that with the dollar the old prices had to be changed.

This situation became profitable for banks, active interest rates went up to 20 % and the inflation picked almost to a 100% until it could become stable after the crisis.

6. Banking System Segmentation and Pending Bank Resolutions

Dollarization came before the solution to the banking failure, Filanbanco and Pacífico remained open with its insolvent situation, they had become mega banks after absorbing financial institutions that had no opportunities to survive by themselves. Depositors trusted more in private banks rather than in the owned or managed by the government.

“Filanbanco failed in August under the weight of illiquidity, mounting losses, and poor administration, despite a second round of recapitalization by the fiscal authorities. Regulators decided to close it. Deposits up to US\$10,000 per depositor have been paid or transferred to private banks, and there is considerable expectation that large depositors will have to take substantial losses.”²¹

Depositors were right, private banks did not suffer the same as Filanbanco. Pacífico did not go through the same situation as Filanbanco because of the quick actions taken by the government to pass it to private administration.

As the mega banks been disbanded or passed to private hands, economic stability came with time. Almost every Ecuadorian remembers the hard times and how the economy was

²¹ DE LA TORRE, Augusto, GARCIA-SALTOS, Roberto, MASCARÓ, Yira, *Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s*, [http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbi0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf), p. 39, access: January, 27th, 2008, 15h09

affected. It is important to know the causes for a crisis and how we moved towards it so we can avoid another one and be prevented to take actions.

CONCLUSION

Since I wanted to know what had happened in the economic of our country, the causes that took us to the worst crisis Ecuador has ever faced, I learned that most of the fault is due to the poor managements we, have had and is the lack of responsibility we have assumed of their acts. We choose our leaders and the people who will represent our needs and wants, but we make a huge mistake when we assume that they have to handle everything and we do not have a voice on their decisions. If they are elected by us, they must tell us what they are doing with our money and how the economy is being carried out. We like to be in silence and accepting everything that the government does, no matter if we do not agree with it, we speak or throw the president when the situation is unbearable and there is no possible solutions.

My monograph shows that the crisis we went through could have been handled and controlled, it could had never caused all that harm to our pockets, but we were pleased by speeches and did not cared about our money and how it was being used. The banking failure erupted and it is a sad part of our history.

If we do not open our eyes we can be falling again into another crisis that can be worst. We are now in a time of changes, where we can put things back in order. Unfortunately we have a Constitutional Assembly that is not working for the wellbeing of all Ecuadorians, and we are not doing anything to stop them, we are living a time of a partial democracy, we do not have the State Powers, and we have a political party doing what it wants with our country and with its future. Maybe we do not see the damages at this moment, but if we do not stop them now when these damages appear it may be too late. The assemblers have to remember why they are in their positions and should represent us in a way that will work out for the best of all Ecuadorians.

Is time to us to speak, why we say History is to learn from our mistakes, if we keep doing the same every time? Is good to be informed, but this information delivers its message if it makes us think about our errors and take actions to do not be fall in the same situation as before. We must love our country and want the best for it, fighting for our rights, needs, stability and development of the nation.

I made a field research in which I made eleven questions to fifty two people in the building of a friend of my father. The first question said if he or she believes in the banking system, the fifty two agreed saying yes. Also they agree that that dollarization helped us; 32 of them know the economic policy of our country, 20 do not. One person thinks that we should change our currency; the others think that we should not. The fifth question has similar answers that the fourth, 52 believe that our situation would not be better with Sucre as a currency and one that it would be. 32 people think that the ideology of our president would not help us to improve our economy, 20 think the opposite. 44 people think that every resource has to be owned by the government, 3 do not and 5 do not know. All of them have their money in national banks, 20 of them were affected by the economic crisis do not. I think that this answer does not reflect how bad the crisis was, but if we review the answers, the people that said yes express how they lost their money, could not use or its debt, the ones that said no is because they did not get hurt so much because of the crisis, its economic situation was really well and did not felt with too much strength malfunction of our economy. 24 of the people invest their money, 11 save it and the others spend it, it shows the ideology we live today, an ideology of consumption. Everyone trusts on private economic entities, 50 have their money in national banks and two in foreign banks. The bank where most people have their money is Pichincha.

The percentages of my research are shown in the tabulation that I made of it; there you can see the results I have explained. It is important to notice that according to this most of the

people support our current economic policy and few had suffered the crisis in all of its extension, as I say we have to consider their financial status, as always the ones that suffer more are the poor people, statistics show how they lost most of their money and had to deal with inflation more than the others.

ENCUESTAS

1. ¿Cree usted en el sistema financiero?		
SI	52 PORCENTAJE	100,00
NO	0 PORCENTAJE	0,00
2. ¿Cree que la dolarización nos ayudo?		
SI	51 PORCENTAJE	98,08
NO	0 PORCENTAJE	0,00
NO SABE	1 PORCENTAJE	1,92
3. ¿Conoce la política monetaria de nuestro país actualmente?		
SI	32 PORCENTAJE	61,54
NO	20 PORCENTAJE	38,46
4. ¿Deberíamos cambiar de moneda?		
SI	1 PORCENTAJE	1,92
NO	51 PORCENTAJE	98,08
5. ¿Sería mejor nuestra situación si seguiríamos con el sucre?		
SI	1 PORCENTAJE	1,92
NO	51 PORCENTAJE	98,08
6. ¿Cree que la ideología de nuestro actual presidente nos va a ayudar a mejorar la economía?		
SI	20 PORCENTAJE	38,46
NO	32 PORCENTAJE	61,54
7. Cree usted que los servicios y recursos de nuestro país deben ser manejados y ser propiedad del gobierno y no de empresas transnacionales?		
SI	44 PORCENTAJE	84,62
NO	3 PORCENTAJE	5,77
NO SABE	5 PORCENTAJE	9,62
8.- ¿Tiene Su dinero en bancos?		
NACIONALES	52 PORCENTAJE	100,00
EXTRANGEROS	0 PORCENTAJE	0,00
9. ¿Se vio afectado económicamente con la crisis del 98?		
SI	20 PORCENTAJE	38,46
NO	32 PORCENTAJE	61,54
10. ¿Qué hace con su dinero?		
AHORRA	11 PORCENTAJE	21,15
INVIERTE	24 PORCENTAJE	46,15
GASTA	17 PORCENTAJE	32,69
11. ¿Qué tipo de entidad financiera considera que es más confiable?		
PUBLICA	0 PORCENTAJE	0,00
PRIVADA	52 PORCENTAJE	100,00
EXTRANJERA	2 PORCENTAJE	3,85
12. Diga el nombre de la entidad financiera que merece su confianza		
INTERNACIONAL	9 PORCENTAJE	17,31
PICHINCHA	19 PORCENTAJE	36,54
GUAYAQUIL	9 PORCENTAJE	17,31
MACHALA	4 PORCENTAJE	7,69
LOJA	4 PORCENTAJE	7,69
PRODUBANCO	3 PORCENTAJE	5,77
RUMIÑAHUI	2 PORCENTAJE	3,85
AMAZONAS	2 PORCENTAJE	3,85

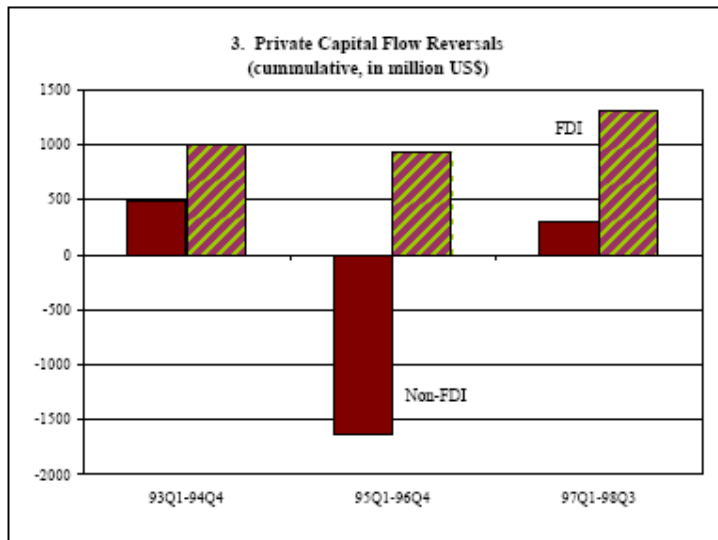
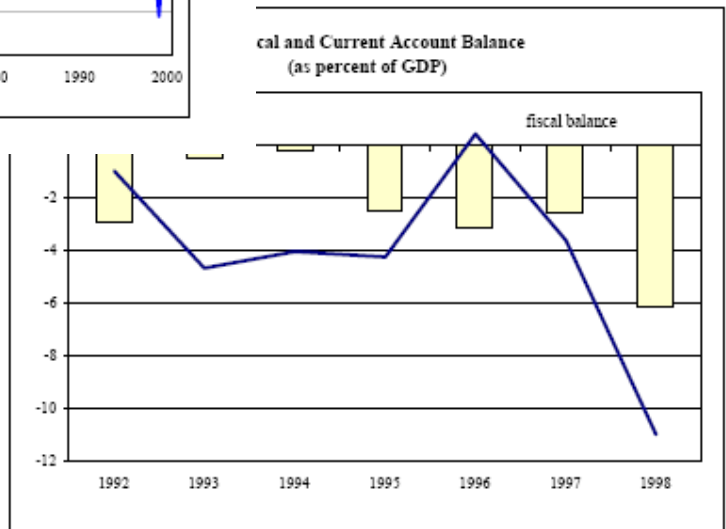
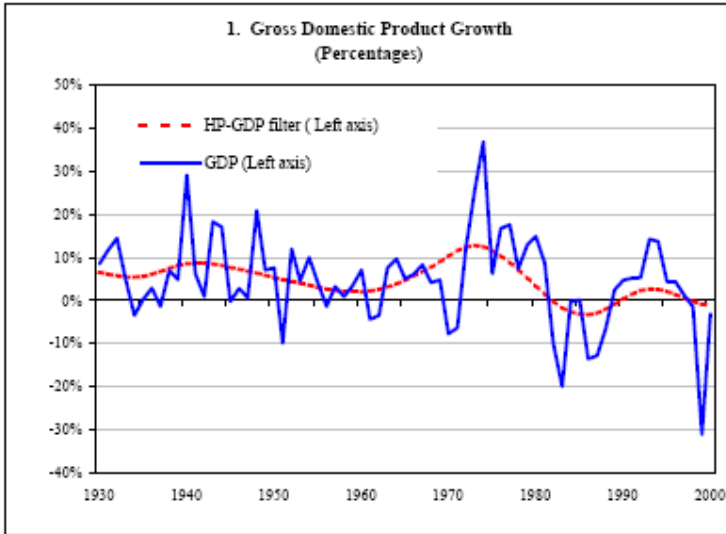
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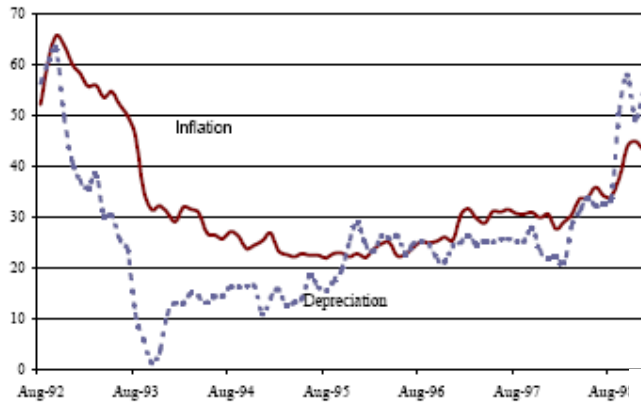
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[http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/\\$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf](http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/e9dd232c66d43b6b852567d2005ca3c5/2bd83dfebb3f5a2c85256c3100545d45/$FILE/Ecuador-%20Financial%20Crisis%20compiled.pdf)

ATTACHEMENTS

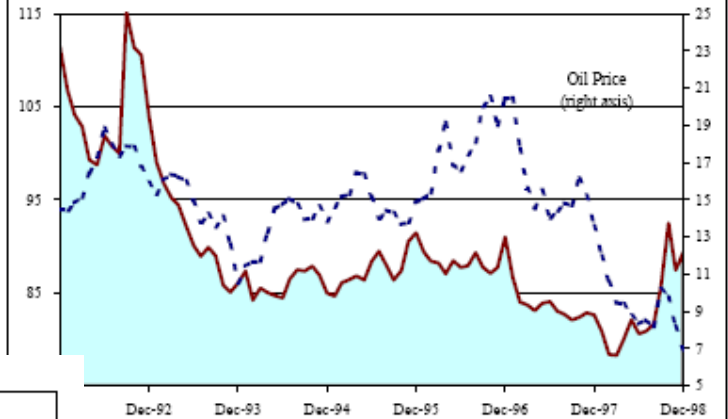
1. CHAPTER TWO: CAUSES FOR ECUADORIAN'S BANKING CRISIS



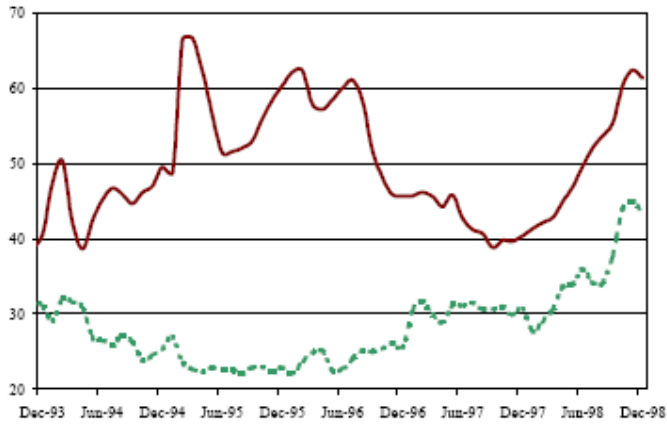
**4. Nominal Depreciation and Inflation Rates
(year on year)**



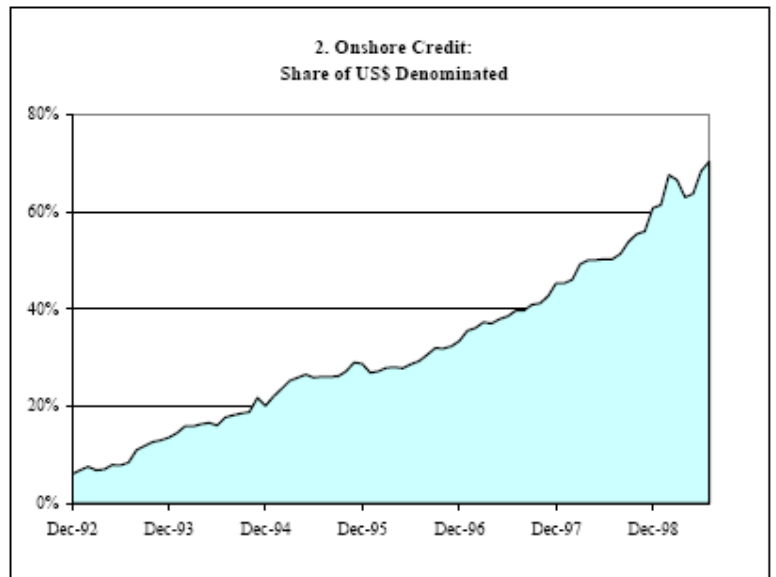
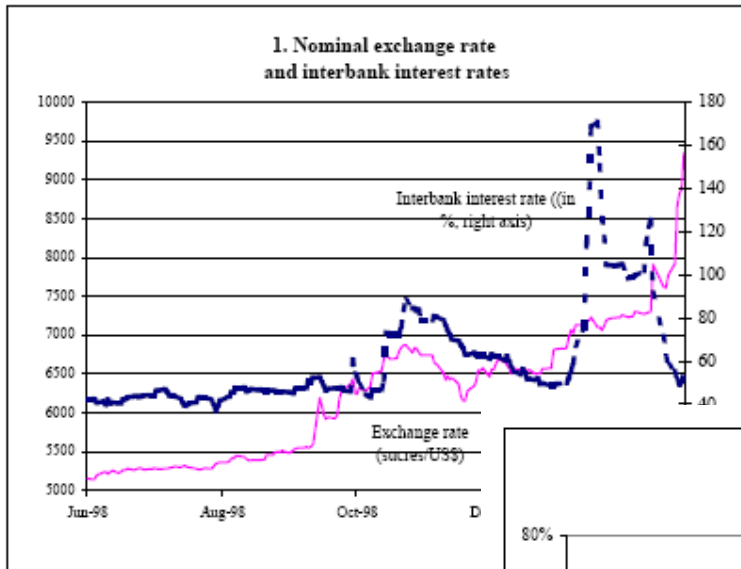
5. Real Exchange Rate Index and Oil Price



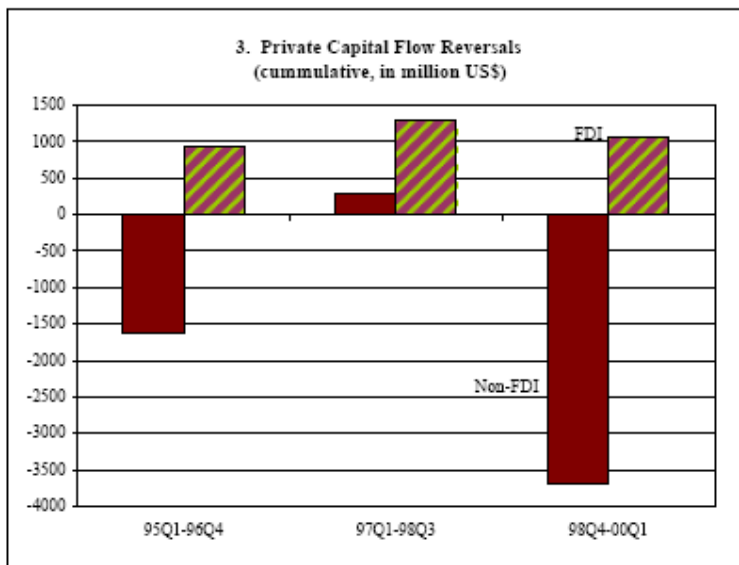
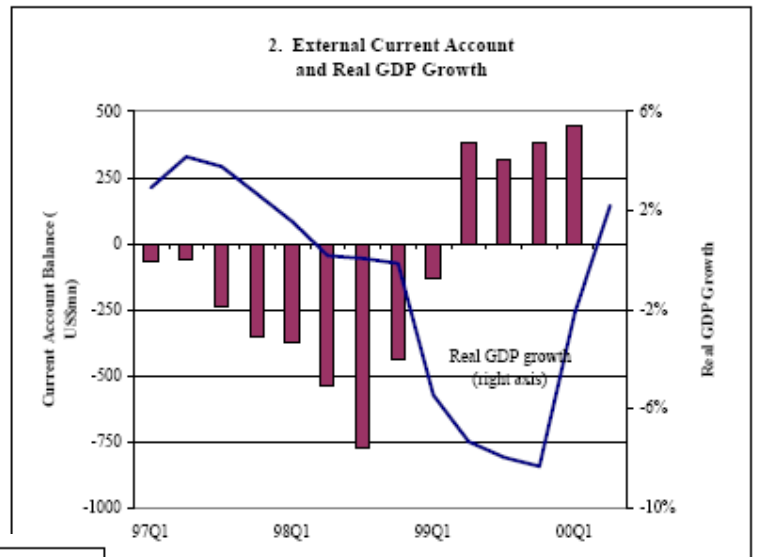
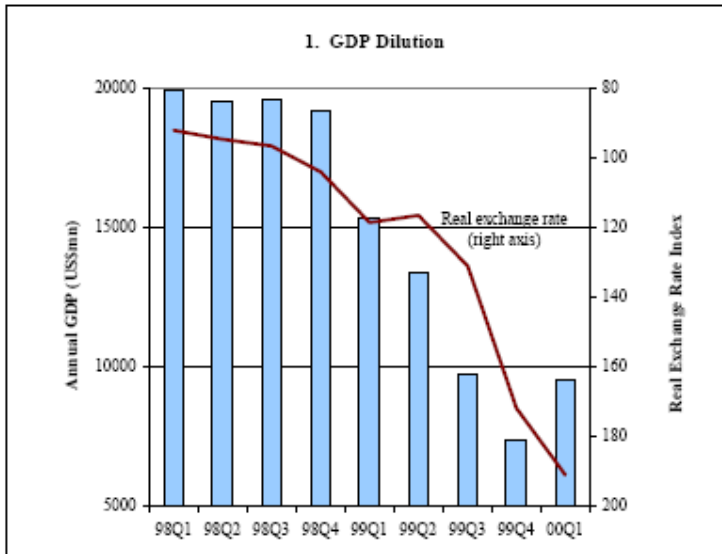
**6. Nominal Lending Interest Rate and Inflation
(percent per year)**



2. CHAPTER THREE: ECUADORIAN'S BANKING CRISIS



3. CHAPTER FOUR: THE DEPTHS OF THE CRISIS



4. BCE Support to Banking System
 (As % of Monetary Base)
 Dec 1997=100



5. Exchange Rate and Interbank Interest Rate

