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'Dollarization' will ensure Ecuador's disintegration

by Cynthia R. Rush

Against a backdrop of surging hyperinflation, mass strikes and protests, and a currency which plunged 18% in the first week of January, Ecuador President Jamil Mahuad went on national television on Jan. 9 and dramatically announced that he intends to "dollarize" the economy. That is, the U.S. dollar would become the national currency, replacing the now almost-worthless sucre.

Mahuad's decision to go with dollarization is a change from March 1999, when he rejected this as an option to deal with the crisis that erupted at that time. His announcement came just a few days after he declared a national emergency, in an attempt to deal with demands that he either resign, or take action to halt an explosion of hyperinflation, in which prices were changing almost hourly, wreaking economic and political havoc.

As Finance Minister Alberto Arizaga clarified a day later, amid general confusion as to the details of the plan, this alleged "stabilization" policy means that Ecuador would become like Panama, the only country in Ibero-America whose currency, which is called the balboa, is actually, and has been since 1904, the U.S. dollar. Ecuador would cease exercising sovereign control over credit issuance, throwing itself instead on the mercy of the U.S. Federal Reserve, which is itself bankrupt, and dollar banking system.

Along with the abdication of currency sovereignty, Mahuad, a technocrat who got his degree at Harvard University's business school, promises to impose a package of harsh new privatization, tax, and labor "reforms" long demanded by the International Monetary Fund (IMF). To get around the Constitution's stipulation that Ecuador have a national currency, he plans to implement the package in three stages over the next year, first pegging the sucre at 25,000 to dollar, and getting Congress to approve enactment of dollarization legislation within 30 days. The process would culminate in the elimination of the Central Bank as a generator of credit, and the complete replacement of the sucre with the dollar. Mahuad told the Central Bank's board of directors that, if they disagreed with the plan, they should resign; three of the five board members, including president Pablo Better, did just that.

Mahuad now claims to have the votes in Congress to ram through austerity measures, based on an alliance with the Roldosista Party of Abdalá Bucaram, the exiled former President, appropriately nicknamed "the madman," who was deposed in 1997 for advocating the same nation-wrecking policies Mahuad is now embracing.

No local crisis

Contrary to assertions from London and Wall Street, Ecuador's crisis is not the result of "mismanagement," "rampant corruption," or failure to adopt "tough" IMF and other "modernizing" reforms. Like Pakistan, Ukraine, and many other countries, Ecuador is a victim of the global financial system's disintegration. A poor country of 12 million people, with pitifully limited infrastructure and the largest per-capita debt in Ibero-America, it has been battered by the sharp decline in prices for its major export commodities—it relies largely on revenue from the export of oil, bananas, shrimp, and cut flowers—as well as by the reduction in trade with countries hit by the global meltdown, and the shutdown of foreign credit lines. Ecuador's bankruptcy is also the result of creditor demands that production and living standards be cut to pay foreign obligations. On Jan. 7, Central Bank officials announced a $7.4 billion gap between total debts due this year, and Ecuador's total combined public and private assets.

In March 1999, a foreign-led speculative assault on the sucre plunged the country into a severe banking and currency crisis. With the sucre devalued by almost 50%, the cost of repaying debt increased. Mahuad tried to compensate by doubling the price of gasoline and freezing half the nation's bank

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accounts, a de facto confiscation. Many of those accounts remain frozen today, although the government has promised to meet the March deadline for unfreezing them. By late September, Ecuador defaulted on the collateralized portion of its interest payments on its Brady bond debt, about $50 million, because, as Mahuad said at the time, the country "cannot, and will not" pay.

A change in policy?

During the March 1999 crisis, as Ecuador's Andean region neighbors nervously monitored events there, the Mahuad government toyed with the idea of adopting the British colonial mechanism of a currency board, or the variant of that adopted in April 1991 by the Menem government in Argentina, known as "convertibility."

An orthodox currency board, of the type peddled by Mont Pelerin Society fanatic Steve Hanke, pegs the local currency to a foreign one—the British pound in the days of the "Empah"—and prohibits credit generation or currency issuance unless it is 100% backed by reserves of that foreign currency. This model doesn't allow for a central bank; Hanke proposes instead that IMF and foreign banking officials comprise a board of directors which will determine local monetary and credit issuance policy. This model also demands imposition of harsh austerity. The Argentine model permits the existence of a central bank, but pegs the peso to the dollar *by law,* and demands that for each peso issued, there be a dollar in reserves to back it up. The central bank's role as "lender of last resort" is also eliminated.

Since April 1991, when the plan was introduced by President Carlos Menem and Finance Minister Domingo Cavallo, Argentina has been locked into the U.S. Federal Reserve system, with dire consequences. Convertibility put an end to Argentina's hyperinflation, for which it was praised internationally as a "miracle." But it subjected the country's physical economy to such vicious looting and financial speculation, while encouraging constant new indebtedness, that Argentina today also faces the threat of economic and physical disintegration.

Mahuad's consideration of convertibility, or even full dollarization, in March 1999, coincided with a campaign to promote these options internationally. In August 1998, Cavallo, an intimate of global speculator George Soros, revealed that he had been asked by Russian Deputy Prime Minister Boris Fyodorov to serve as an adviser to the Russian government on monetary policy, probably to include adoption of a currency board. Amidst great media hype, Cavallo travelled to Moscow, and was also reportedly hired by the Ukrainian government as a consultant. Argentine media reported in late September that Cavallo would also advise Brazil on some kind of currency board plan, and in early October, the egotistical Harvard grad also recommended that Mexico adopt a currency board.

Interviewed at the time by Argentina's *Página 12* newspaper, Hanke lamented, "I tried to sell" the convertibility idea to the Russians in 1993, "but they didn't want to buy. The IMF said no." Hanke also tried to sell his currency board scheme to Indonesia in 1997, discussing the idea with President Suharto. But IMF Managing Director Michel Camdessus nixed the plan.

In September 1998, right after Cavallo's Russian adventure, Menem announced that he wanted to completely dollarize Argentina's economy, as the only way to eliminate any risk of currency devaluation and ensure low interest rates. The proposal set off a debate that was still going strong at the time of Ecuador's March 1999 crisis. On March 8, as Ecuador was reeling, Harvard University economics professor Robert J. Barro, in an article for the *Wall Street Journal* entitled "Let the Dollar Reign From Seattle to Santiago," praised Menem to the skies. On March 11, a group of Mexico's most powerful businessmen ambushed President Ernesto Zedillo in a private meeting, with a proposal to scrap the peso and dollarize Mexico's economy. In a press conference later, business leader Eugenio Clariond Reyes held up the example of Panama. "Previously, each country had to have a flag, a national anthem, and a currency, as a symbol of sovereignty . . . but now . . . look at Panama," where the dollar is the real currency and the whole system "works very well."

A suicidal strategy

Despite all the lobbying, the currency board or dollarization options never materialized, in Russia, Indonesia, Brazil, or Ecuador. The IMF was adamantly opposed, as was then-U.S. Treasury Secretary Robert Rubin, although Lawrence Summers, Treasury Undersecretary at the time, was more favorable to the idea.

But today things are different. The global financial crisis is that much further out of control, and Summers is now at Treasury's helm. In response to Mahuad's Jan. 9 announcement, the IMF's Camdessus coyly indicated that the Fund "doesn't oppose" dollarization, and on Jan. 11, State Department spokesman Jamie Rubin praised Mahuad's announcement as a "bold step" toward "far-reaching, fundamental changes to the financial system of Ecuador."

If the international financial oligarchy now intends to promote dollarization as a way to "stabilize" the crisis-wracked countries of Ibero-America or Asia, as these statements imply, the results will be far worse than the destabilizations unleashed so far by the global financial meltdown.

State Department support for Ecuador's dollarization proposal has had immediate, nasty results. In response to Mahuad's announcement of dollarization and privatization, Ecuador's national indigenous organization CONAIE, and the narco-terrorist-allied Patriotic Front, launched a "general uprising" on Jan. 12 aimed at overthrowing the government and establishing a "plurinational" state—effectively the breaking up of Ecuador into small ethnic tribes. Like the narco-terrorist insurgencies in the rest of the Andean region, which will be bolstered by this process, this is a real national security threat to the United States and the hemisphere.