

UNA PROPUESTA DE RECUPERACIÓN ECONÓMICA EN UNA ECONOMÍA DE RECESIÓN: UN ANÁLISIS DE ECONOMÍA ECUATORIANA Y CIUDADES FRONTERIZAS.

A PROPOSAL FOR ECONOMIC RECOVERY IN A RECESSION RIDDEN ECONOMY: AN ANALYSIS OF ECUADORIAN ECONOMY AND BORDER CITIES.

Halim Austin Obiajulu Joe is a graduate of Economics from the prestigious University of Lagos Nigeria, hold an advanced level certificate in G.C.S.E A/L London, a diploma in banking and finance, TOEFL B2 certificate and a masters degree in quality education management from the North Technical University (UTN) Ibarra (Final year student). A research analyst in political economics, and scientific articles. Versatile in international political economy. Co-authored book in management of quality education. Presently, an erudite lecturer in the State Polytechnic University of Carchi (UPEC) Tulcan.

UNIVERSIDAD POLITÉCNICA ESTATAL DEL CARCHI

austin.halim@upec.edu.ec

SUMMARY

Many critics of dollarization of Ecuadorian economy should also count the achievements dollarization policy has avail Ecuador. Economically, countries with balance of payment problems are mandated internationally to devalue their currency, devaluation of Ecuadorian Sucre would have been a disaster for Ecuador seeing that Ecuador as a country is not industrially developed rather it's operating a monotonic economy highly dependent on export of crude oil and pre-processed agro product. Secondly, seigniorage which to Ecuador is a huge gain, since the country is not responsible for the cost of printing their official currency. Paradoxically, would have been an expenses if the government operates a Sucre economy. Although the present government has made tremendous changes and also measurable achievements Kudos to the government of Rafael Correa, there is still enormous economic challenges and Immense gap between the poor and the reach which next government need to tackle to alleviate the present economic hardship. Establishment of a free trade zone is a panacea to conquer challenges posed by Colombian Pesos to Ecuadorian economy. FTZ is a card changer to minimize brain drain from border provinces and rekindle commercial activities as well as generate enormous employment opportunity which will in turn increase government revenue, exterminate poverty and curb recession being experienced presently by the economy due to fiscal policies. Tax policy is economically lucrative in correcting economic anomalies but government should also take into consideration the ratio of unemployment to Employment which directly determines purchasing power and any attempted increment in taxation should be within a stipulated economic period in order to match economic growth with development.

Number of pages in PDF: Keywords: seigniorage, dollarization, free -trade zone (FTZ), Mop-up liquidity, crowding-out.

ABSTRACT

This research work is focused on the present economic and financial situation facing Ecuadorian border province, a critical look at Tulcan a Border town near Colombia the choice place where most Ecuadorian prefers shopping most of their domestic and other consumable product. The effects on the Ecuadorian economy and particularly on business and commercial activities in the province of Carchi.

The research went further to examine the problems prospects poverty and unemployment level in the province reasons for brain drain and why young graduates from the province abandons the city for greener pastures in other bigger cities like Guayaquil and Quito also proffers economic solution on ways to boost commercial activities in the said province in order to generate employment and curb the rate of youths migration to other cities. Finally, provided a tentative suggestions on how to counter the these crisis by establishing a free trade zone which apparently will change the economic power play and purchasing attention back to Ecuador. The rush to Ipiales was consider economically important due to the constant fluctuation in the value of Colombian Peso to the dollar which triggers consumers preference for Ipiales a Colombian border town with Ecuador. The article discusses the benefits of free trade zone to Ecuador and how it will strike a balance between the Ecuador official currency(U.S Dollar) and the Colombia Peso.

1. INTRODUCTION

This research was prompted by the current challenges posed by the devaluation of Colombian Pesos a threat to elasticity of demand and supply in Ecuadorian economy, with a focus to finding a lasting solution to this menace

“Given Ecuador’s lack of a local currency and the limited liquid assets needed to confront the complex economic situation, the new global context has triggered a significant decline in domestic demand, especially public demand. The government has been forced to sharply reduce public investment and to curb spending, despite efforts to explore external financing options and increase non-oil revenue. This reduction of public spending has negatively affected economic activity, despite government protection of strategic investments and more rational public spending. Additionally, the rapid macroeconomic deceleration has affected prospects of households and firms – reflected, for example, in levels of consumer and business confidence, as well as private consumption levels – putting added pressure on domestic demand”(world bank, 2016)

“Colombia's consistently sound economic policies and aggressive promotion of free trade agreements in recent years have bolstered its ability to weather external shocks. Real GDP has grown more than 4% per year for the past three years, continuing almost a decade of strong economic performance. All three major ratings agencies have upgraded Colombia's government debt to investment grade”.(CIA factsbook, 2013).

The unresolved questions are, how to minimize influx of Ecuadorian trooping into Ipiales and other neighboring countries to purchase goods and services at cheaper rates thereby enriching Colombian economy instead of their economy?

Secondly, How to boost economic activity in a recession ridden economy? The problem presently plaguing commercialization of Ecuador's border cities especially Tulcan.

The Ocean of Ecuadorians flocking into Colombia everyday which almost 80% with a motive to go shopping on domestic items or services was a result of devaluation of the Colombia Pesos and the cheaper commodity prices due free trade agreement between Colombia and global world. Which enables good and services to enter into Colombia voidable of tariffs and customs duty as compared to Ecuador the neighboring country. This attitude contrary enriches Colombia's economy and underscores economic projection and investment hopes in Ecuadorian economy. It illustrates that more goods and services will be abandoned in Ecuador while more money in a Ecuador will be chasing few goods in Colombian and other neighboring countries.

2. JUSTIFICATION

This research was necessary in order to address the present economic hardship, migration, by youths from border cities of Ecuador to other cities in search for greener pasture and the almost fast liquidation of private and small-scale businesses in the border towns due poor patronage of made in Ecuador goods by Ecuadorians and preference to shop in Colombia cities of Ipiales and Pasto etc.

Free trade zone is an area or zone in a country where goods can freely arrive, handled, reconfigured or manufactured and later be re-exported without being subjected to customs duty or any form of tariff by the government of a country operating a free trade zone.

Goods from a free trade zone are only subject to taxes, duties only when such goods from same free trade zone are allowed to be traded in the same specific economic zone. For example, if goods landed in in a free trade zone established by Ecuadorian government and re-exported into Ecuador, the government can impose duty on such re-exported goods. Generally, economist will favor the opinion that free trade zone provides are cheaper overhead cost which will in turn lower consumption cost to the final consumer and add more consumers to the market. The idea of a free trade zone is to increase economic growth, attract employers reduce poverty and unemployment.

In China, the government has noticed the crackdown of their once robust financial economic growth and resorted to free trade zone as a re-tooling factor to revamping the Chinese economy.

3. Argument against dollarization of Ecuadorian economy.

To encourage even economic growth and development government should consider Anthony Thirlwall law as stated below: "Thirlwall's law (named after Anthony Thirlwall) states

that if long run balance of payments equilibrium on current account is a requirement, and the real exchange rate stays relatively constant, then the long run growth of a country can be approximated by the ratio of the growth of exports to the income elasticity of demand for imports” (Thirlwall, 1979).

A country is said to adopt unofficial dollarization policy when citizens of such country spend foreign currency together with local currency or officially dollarization when the country uses a foreign currency as a legal tender in every facet of its daily transaction within the country's territory. In practice, Ecuador may be said to have official dollarization even though few of its local coins are equivalents to the United States cents are used alongside the United States Dollars.

Many arguments have been posed either in form of constructive criticism or in the corollary in favor or against the adoption of a dollarized economy initiated by Jamil Mahuad regime, perfected by Gustavo Noboa an elected vice president turned president. The economic collapse in 1999 was caused by several developments ranging from devaluation of Sucre in February, default in external debt payment in September, and the overall political instability coupled with non-dimensional policies in March, drew much agitation for economic reform. Official dollarization function in absolute terms when binational countries sharing same boarder post floats or spends same official currency which is contrary in the case of Colombia and Ecuador which share border to the north of Ecuador, while Ecuador uses The United States Dollar, Colombia spend Colombia peso which its present official exchange rate to the U.S Dollar as at the time of filing in this project investigation stood at 3,000 Colombian Pesos to 1 USD\$.

This accounted for an unabated queue of Ecuadorians rushing to make their key purchase in Ipiales, Pasta and other Colombian cities. Another cogent factor, is the free trade zone and bilateral trade agreement between Colombia and other countries especially the United States of America among others. Ecuadorian government cannot devalue the Dollar due to the fact that Ecuadorian Economic is practically an officially dollarization economy, which advocates of return to Sucre have criticized during the 2015/2016 economic recession a result of a fall in crude oil prices in the international market and dependency on pre-processed agro export by the Ecuadorian economy.

Developing economies often experience high and unstable inflation rates when their governments increase the money supply to finance higher levels of government spending. High and unstable inflation rates result in a more unstable investment climate and a lower rate of economic growth. When people lose faith in the domestic currency, it is not uncommon for another currency to be used as a medium of exchange in the domestic economy. Because of its relative stability and use as an international reserve currency, the U.S. dollar frequently is used for this purpose. "Dollarization" is said to occur when the U.S. dollar replaces the domestic currency as the official medium of exchange.

(Shelton, April, 22, 1999)

Advocates of dollarization suggest that developing economies that replace their less stable domestic currency with the U.S. dollar experience a lower and more stable inflation rate. A lower and more stable inflation rate, in turn, is expected to lead to a higher level of investment and a faster rate of economic growth. This benefit is larger when the domestic monetary authorities have established a poor track record in maintaining a stable domestic money supply.

According to dollarization advocates, LDC's which replaced their unstable domestic currency with a foreign currency such as dollar/ euro are bound to have lesser inflation and a better stable economy which is capable of spurring investment and increase growth. Official dollarization will not attain it's potentials if it doesn't make more efforts other than using foreign currency. When financial institutions are allowed freedom of interplay in absence of bias against foreign financial institution which undertake same responsibility : (accept deposit and make loan), this will lead to full financial integration. Other benefits of dollarization includes: reduction of inflation from double digits to single digit that many countries struggle to achieve. Lower inflation guarantee prices of goods and services which is what Ecuador enjoy in the form of present day stability in the price of properties. In addition, government might take advantage of "seigniorage" which may be counted as revenue for a government when the money that is created is worth more than it costs to produce it. This revenue is often used by governments to finance portions of their expenditures without having to collect taxes.

A critical and analytical look at correaism, a nomenclature for Rafael Correa economic political ideology, Rafael Correa a seductive good looking economist who was saddle with the task of resuscitating a country plagued with political instability and economic humiliation with an almost collapsing currency which was vetoed for a change to U.S dollar. Despite remarkable economic changes and achievements of the Correa's government, there are major policy mistakes mainly the policy of crowding out which the government embarked on in order to sanitize the public sector, thereby channeling almost all energy and resources to the public sector while the private sector was left to wobble. Subsequently, a lopsided labor sector.

The policy only succeeded in the development of human capital left to compete with few job opportunities which the public sector could generate instead of floating a free enterprises where the public and the private sector interplays to add more job opportunities since the public sector can not contain the yarning of the population of almost 18 million people forecasted by the economy. Having flooded the Ecuadorian economy with millions of dollars in cash and loan, policy makers are now obsessed on how to mop up excesses, to avoid hyper-inflation then, saw the present increase in taxation that left the economy in a creeping inflation.

The present recession has thrown a once vibrant economy into a pandemonic economic situation with an almost absent of clue to a resilient solution, while the common man becomes a victim of circumstance. Government is also taking its turn in this epileptic challenges of restoring hope on the economy by creating more job opportunities which will pilot the economy from the present recession. But analyzing economic projection from

the table below: It is obvious that there is still doubt in the future of employment and dis-employment come the year 2017.

PROYECCIONES ECONOMICAS				
América del Sur	PIB		DESEMPLEO	
	2016	2017	2016	2017
Brasil	-3.8	0.0	9.2	10.2
Argentina	-1.0	2.8	7.8	7.4
Colombia	2.5	3.0	9.8	9.4
Venezuela	-8.0	-4.5	17.4	20.7
Chile	1.5	2.1	6.8	7.5
Perú	3.7	4.1	6.0	6.0
Ecuador	-4.5	-4.3	5.7	6.5
Bolivia	3.8	3.5	4.0	4.0
Uruguay	1.4	2.6	7.8	7.6
Paraguay	2.9	3.2	6.2	6.1

Fuente: Fondo Monetario Internacional EL UNIVERSO

(fondo monetario internacional, 2016)

Nonetheless, the above data from international monetary fund propose and increase unemployment come 2017, however, there is new hope from a bleak economy which signs are clearly written from the sharp recovery which the Ecuador economy has recorded in the face of recession from the last few months. Judging by statistical data and government propaganda tools. Although the common people are yet to get the feeling on the widely announced economic recovery from recession, as we all know, recovery is a gradual process.

“The biggest sector of Ecuador’s economy is services. Retail and wholesale trade, hotels and restaurants, transport, communication and warehousing, financial intermediation, professional, technical, administrative and household services, education and health and government services and goods account for 57 percent of the GDP. Manufacturing, mining and quarrying create 23 percent of the wealth and construction and water and electricity distribution 11 percent. Agriculture, forestry and fishing account for the remaining 9 percent of GDP”. (banco central, 2016)

Therefore notable advancement in technology is stalled by inability of the government to attract foreign investment due to high investment tax as a result development strategy in Ecuador is partial human capital based. The country cannot compete with other Latin America countries like Argentina and Brazil.

Free Trade Agreement.

Much has been said about establishing a free Zone in almost every border town in Ecuador as a solution to tackling Ecuadorians shopping spree in Columbia and other neighboring countries of Ecuador. The Correa government has signed virtual all agreement need for a take off of FTZ but web-foot attitude of the government made the implementation of the monumental agreement a mirage.

Benefits from the FTZ are innumerable as both transport companies, subsidiaries and indigenous firms can recount huge benefits ranging from reduction in operating cost of importation of raw material from China and other countries will be drastically reduced. Apparently, FTZ is an alternative way of creating jobs which is subsequent to springing-up of subsidiary industries that takes advantage of the FTZ to create both minor and major employment opportunities thereby mitigates job creation burden on the government.

Research methodology used.(QUALITATIVE METHOD)

Table: 1

Ecuador GDP	Last	Previous	Highest	Lowest	Unit
<u>GDPGrowthRate</u>	-1.90	0.10	3.40	-1.90	percent
<u>GDPAnnualGrowthRate</u>	-3.00	-1.20	10.20	-3.00	percent
<u>GDP</u>	100.87	100.92	100.92	1.00	USD Billion
<u>GDPConstantPrices</u>	17113228.00	17442047.00	17662856.00	9134587.00	USD THO
<u>GrossFixed Capital Formation</u>	4391411.00	4575073.00	4806365.00	1324528.00	USD THO
<u>GDP per capita</u>	5337.17	5402.52	5402.52	2215.09	USD
<u>GDP per capita PPP</u>	10717.60	10848.82	10848.82	7387.62	USD
<u>GdpFromAgriculture</u>	1315940.00	1311096.00	1315940.00	787431.00	USD Thousand
<u>Gdp From Construction</u>	1710330.00	1754304.00	1820268.00	499868.00	USD Thousand
<u>Gdp From Manufacturing</u>	2048837.00	2067595.00	2081085.00	1094728.00	USD Thousand
<u>Gdp From Mining</u>	1696996.00	1672496.00	1762426.00	880806.00	USD Thousand
<u>GdpFromPublicAdministration</u>	1062128.00	1106887.00	1111154.00	535146.00	USD Thousand
<u>GdpFromServices</u>	1114297.00	1120753.00	1139467.00	863720.00	USD Thousand

Ecuador GDP	Last	Previous	Highest	Lowest	Unit
<u>GdpFromTransport</u>	1173493.00	1187843.00	1192025.00	666729.00	USD Thousand
<u>GdpFromUtilities</u>	441097.00	438980.00	441097.00	121724.00	USD Thousand

The table above shows that economic growth rate was at it lowest of -1.90 as against 0.10 and 3.40 in the penultimate years. While GDP annual growth recorded in the penultimate years -1.20 and 10.20 to a record low of -3.00 in 2016

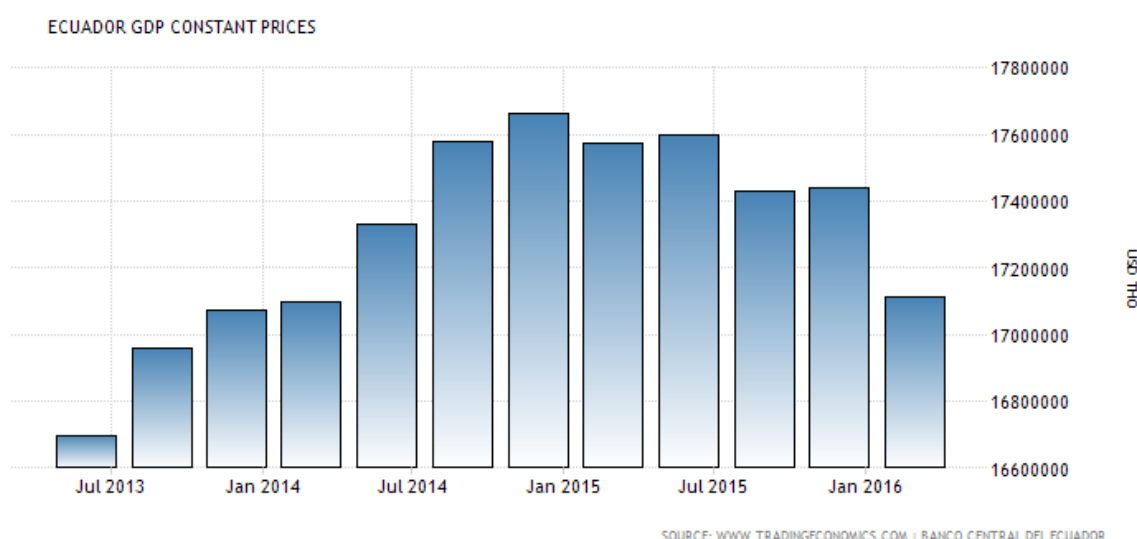


FIG. 1 Ecuador GDP Constant Prices 2000-2016

GDP Constant Prices in Ecuador decreased to 17113228 USD thousand in the first quarter of 2016 from 17442047 USD thousand in the fourth quarter of 2015. GDP Constant Prices in Ecuador averaged 13356092.74 USD thousand from 2000 until 2016, reaching an all time high of 17662856 USD thousand in the fourth quarter of 2014 and a record low of 9134587 USD thousand in the first quarter of 2000. GDP Constant Prices in Ecuador is reported by the (Banco Central del Ecuador.) Such as decrease was accounted by:

- Fall in crude oil prices
- increased taxes
- fiscal and monetary government policy.
- Budget adjustment.

These policies employed by the government in the fiscal year 2016 in order to curb recession for the fall in GDP in 2016 as can be seen from the graphical analysis above.



FIG: 2

Actual	Previous	Highest	Lowest	Dates	Unit	Frequency	
1315940.00	1311096.00	1315940.00	787431.00	2000 - 2016	USD Thousand	Quarterly	Constant prices 2007, SA

Ecuador Gdp from Agriculture- actual values, historical data, forecast, chart, statistics, economic calendar and news. Ecuador Gdp From Agriculture - actual data, historical chart and calendar releases as was last updated on July of 2016, Shows an increase in agricultural GDP due to government farm support programs such as :

Agricultural mechanization

Agricultural loan

Construction of road to ensure produce reach the market

Provision of agricultural storage facilities.

Improved seedlings.



FIG: 3

Ecuador Gdp From Oil and Mining - actual data, historical chart and calendar of releases as updated on July of 2016, Shows a fluctuating oil and mining prices due to global factors in the international market from the graphical record above the first quarter of 2016 was the was hit with a record low below 1680000.



FIG: 4

A consumer price index (CPI) measures changes in the price level of a market basket of consumer goods and services purchased by households. The CPI is a statistical estimate constructed using the prices of a sample of representative items whose prices are collected periodically.(search f. g.)

Look at consumer price index (CPI) shows that prices of consumer goods and services was fluctuated after July 2015 - October 2015 while an upward increase in price from

April 2016 thereafter, consumer price index recorded it worst increase after April 2016 from 104.37- 105.38 due increase in taxes

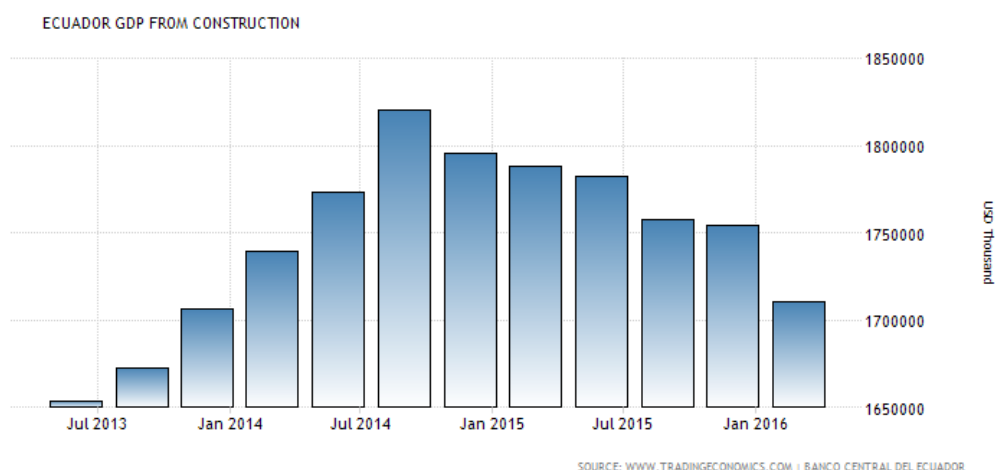


FIG. 5

Ecuador GDP from construction recorded its highest peak in July 2014 which was due to government pumping in of more capital to construction and also a stable crude oil prices and internal revenue return. The record shows a downward slope from July 2015 to January 2016. The worst record was July 2013.

Ecuador Economy Data Table: 2

	2011	2012	2013	2014	2015
Population (million)	15.3	15.5	15.8	16.0	16.3
GDP per capita (USD)	5,193	5,665	6,008	6,297	6,078
GDP (USD bn)	79.3	87.9	94.8	101	98.9
Economic Growth (GDP, annual variation in %)	7.9	5.6	4.6	3.7	0.3
Consumption (annual variation in %)	5.7	4.3	4.2	3.5	0.3
Investment (annual variation in %)	14.3	10.6	10.7	5.3	-2.5
Industrial Production (annual variation in %)	5.8	3.4	5.6	3.0	1.6
UnemploymentRate	6.0	4.9	4.7	5.1	5.4
Fiscal Balance (% of GDP)	-0.1	-0.9	-4.6	-5.3	-5.3
PublicDebt (% of GDP)	18.4	21.2	24.1	29.9	33.1

	2011	2012	2013	2014	2015
<u>Inflation Rate (CPI, annual variation in %, eop)</u>	5.4	4.2	2.7	3.7	3.4
<u>Inflation Rate (CPI, annual variation in %)</u>	4.5	5.1	2.7	3.6	4.0
<u>Inflation (PPI, annual variation in %)</u>	12.5	-3.4	3.8	-19.1	-12.9
<u>BenchmarkInterestRate (%)</u>	4.53	4.53	4.53	5.18	5.14
<u>CurrentAccount (% of GDP)</u>	-0.5	-0.2	-1.0	-0.6	-2.2
<u>Current Account Balance (USD bn)</u>	-0.4	-0.2	-0.9	-0.6	-2.2
<u>Trade Balance (USD billion)</u>	-2.1	-1.7	-0.6	-2.0	-3.2
<u>Exports (USD billion)</u>	22.3	23.8	24.8	25.7	18.3
<u>Imports (USD billion)</u>	24.4	25.5	25.5	27.7	21.5
<u>Exports (annualvariation in %)</u>	27.6	6.5	4.6	3.5	-28.7
<u>Imports (annualvariation in %)</u>	18.7	4.3	0.0	8.8	-22.4
<u>International Reserves (USD)</u>	3.0	2.5	4.4	4.0	2.5
<u>ExternalDebt (% of GDP)</u>	19.4	18.2	19.8	24.1	-
Analyzing data from the above table, shows that In June 2016, economic activity recorded an annual decrease of 2.1%, according to the monthly indicator for economic activity					

(IDEAC, agosto 11, 2016)

Economist are of the opinion that with this economic climate, Ecuador's economy is forecast to slip into a deep recession. Economist see GDP contracting 3.2% this year, which is down 0.3 percentage points from last month's forecast. Economist expect the economy to record a smaller decline of 0.2% in 2017 Unless, government step up policies geared towards reinstating the economy. IDEAC,9, Agosto 2016)

“If the real exchange rate varies considerably, but the price elasticities of demand for imports and exports are low, the long run growth of the economy will then be determined by the growth of world income times the ratio of the income elasticity of demand for exports and imports which are determined by the structural characteristics of countries. One important example of this is that if developing countries produce mainly primary products and low value manufactured goods with a low income elasticity of demand, while developed countries specialize in high income

elasticity manufactured goods the developing countries will grow at a relatively slower rate” (Davidson, 1991).

4. CONCLUSION

Finally, there is an incessant ad vocation although it might seem as a mystical, tortuous, rambling discourse which sounded to me as a good deal for government to revisit its fiscal and monetary policies with an aim to make some fine-tuning that will reverberate the economy restore hope and improve the standard of living of a common man which was among the political manifest of the present government. No doubt, the government is not folding its arms but the distractions of the global recession a fall in global oil price and other economic consequences are also one of the threatening factor to achieving these objectives. Low oil prices are among the major factors that has squeezed the economy.

Therefore, government should diversify and look into mechanized agriculture in order to boost revenue and augment oil revenue to keep the economic wheel on the march again. The agitation to de-dollarization will be on the increase if the present low oil price continues so as to be able to encourage export and refinance deficit from the coming year but advocates should also reconsider the larger benefits of dollarization as discuss extensively in this research work. However, there is a large hope the economy will recover as the country look forward to gain from it major social investment from the next year.

5. RECOMMENDATIONS

Much has been discussed as evident to support a change in government policies in the next dispensation , 2017. Therefore, in my opinion, Policy statement should include:

1. Establishment of free trade zone in each border city to reduce shopping and enrich neighboring countries and engaging in more trade agreement with other countries.
2. Government should implement TRUE CAPITALISM to avail equal opportunity for private and public sector. Where there is competition, it encourage efficiency, efficacy and quality.
3. Good bargain for foreign investors by creating a conducive environment and a reasonable tax policy for investors to investor.
4. Implement price daily pricing propaganda to get the citizens informed on prices beyond borders this awareness will curtail the influx of people to neighboring country, also implement a pricing policy of (price floor and price celling to monitor inflation rate).
5. Encourage export activities, by creating 21st century technological advanced products and services instead of pre-processed product which has little bargaining power in the international market. The united states of America is among the largest exporter in the world and countries continues buying from the U.S in same Dollar currency obtainable in Ecuador.
6. Embark on debt buy back to improve balance of payment problem. This will be discuss in the next publication.

7. Lift of ban on safeguard tariffs; that and other hostile Ecuador's foreign policies in a way might account for the sluggish moves on the part of the European community in admitting Ecuador as a visa free country to Europe which other neighboring countries in Latin America are presenting enjoying.
8. A constructive reform on capital tax system is necessary to attract foreign investment.
9. Government should eschew unhealthy competition in form of crowding out against the private sector as the challenges of creating job opportunities is a collective responsibility of the private and public sector respectively. Figures from the Fiscal Policy Observatory 2006 statistics data had it that almost 80% of total investment in 2006 was from the private sector which dwindled in consecutive years due the government policy of crowding out and unhealthy competition against the private sector.
10. Government should embark on a bail out policy to restore and revitalize the private sector which has recorded a menace of liquidation of private businesses due to harsh government policies.

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