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How Ecuador is dealing with declining oil revenues

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Ecuador's budget cuts, coupled with increased investments from China and the adoption of protectionist measures, are reducing the impact of the decline in the price per barrel.

Ecuador (the smallest member of OPEC) recently came under tax revenue pressure due to the fall in crude oil prices that began in the third quarter of 2014. Oil accounts for a fifth of the Andean nation's revenues and more than 50% of its exports. The decline, combined with a stronger US dollar, had a nearly 2 billion dollar impact on the country during the first quarter of 2015. However, the current president of the country, Rafael Correa, has already implemented several measures to address these effects. Notably, the government has ensured that investments in infrastructure will not cease.

This is easily explained. In recent years, a dynamic and aggressive public spending policy in strategic sectors such as roads, hospitals, schools and power plants (going from 21% of GDP in 2006 to 43% in 2014) has been implemented, stimulated by historic oil price levels. And growth has largely benefited! Today, however, times have changed. Ecuador suffers not only from the fall in oil prices but also from its "dollarized" economy which prevents it from having recourse to conventional monetary policies when faced with deliberate devaluations in neighboring countries. The government has had to implement three measures to mobilize additional resources. The first, reducing the federal budget by 3.7 billion dollars (through savings on fuel purchases, pension funds and the salaries of public officials), however, is likely to hit the poorest populations hardest during an economic slowdown. Yet the two other measures could benefit these same people: on the one hand, the adoption of protectionist policies (an increase in import duties for 2,800 products and the maintaining of import quotas); and on the other, an increase in foreign investment through agreements with China (7.2 billion dollars over the next five years), bond issuance, and loans from international organizations such as the Inter-American Development Bank.

Furthermore, the flagship strategy of the Ecuadorian authorities has been to promote social development projects designed to benefit the bottom of the pyramid. The Economía Popular y Solidaria (social and solidarity economy) that defines the framework of this strategy is defined as "a mode of economic organization in which the members unite to produce, exchange, market, finance and consume goods and services that will allow them to meet their needs and to generate income." This has strengthened the microfinance sector. Since late 2012, the Superintendencia de Economía Popular y Solidaria effectively regulates the institutions operating under this system (including and in particular cooperatives that, along with specialized banks and NGOs, make up the sector) in a demanding manner.

In the end, protectionist policies, coupled with the strengthening of the strongest cooperatives, are thus an opportunity to seize for the portion of the population working mainly in the local production sector (agriculture, textiles and livestock). And, despite a difficult first half of 2015, public investments made by Ecuador should start to bear fruit and local industry will be able to take advantage of these advances to become more competitive. Given political and economic stability, low inflation and unemployment rates, and sustained GDP growth (4% in 2014), there are good reasons to believe that a potential economic slowdown is no longer much of a threat. Especially if the recent crude oil price rebound continues.

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