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The Impact of Foreign Aid on the Dependency of Recipient Countries: The Dollarization Policy of the Government of the Republic of Ecuador

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ABSTRACT: This study examines the relationship between foreign aid and recipient-country dependence through a case study of the Republic of Ecuador, focusing on the period following the implementation of the dollarization policy in 2000. Using dependency theory, complex interdependence, and institutional approaches, the research finds that although foreign aid provides short-term economic stabilization and facilitates post-crisis recovery, it simultaneously reinforces fiscal and structural dependence on international institutions and donor states, especially the United States. Dollarization, initially intended to curb inflation and restore market confidence, significantly reduced Ecuador's monetary sovereignty and deepened its reliance on external economic policies. Findings from the literature and policy evaluations indicate that IMF assistance through the Extended Fund Facility (EFF) improved fiscal governance and strengthened social protection, while also contributing to long-term dependency patterns exacerbated by the loss of national monetary instruments. Efforts to diversify development partnerships, such as cooperation with Indonesia and the People's Republic of China, offer new opportunities but also carry the risk of increasing external debt burdens. The study concludes that without a comprehensive exit strategy and strengthened domestic economic capacity, Ecuador is likely to remain trapped in a cycle of external dependence that constrains its long-term economic sovereignty.

KEYWORDS: Foreign Aid, Economic Dependence, Dollarization, Ecuador, and Monetary Sovereignty

I. INTRODUCTION

The Republic of Ecuador is a country in Latin America, with its capital in Quito. As of March 2025, the Republic of Ecuador's total population is 18,249,223, accounting for approximately 0.22% of the world's total population, and it has a land area of 248,360 km² (Worldometer, 2025). The history of the Republic of Ecuador is long. In the early 15th century, the territory of Ecuador was part of the Inca Empire, which divided its rule between Quito and Cusco. However, internal divisions enabled Spain to enter and colonize the region in the early 16th century. Spain successfully colonized the area for approximately 300 years and declared independence on August 10, 1809, but this independence lasted only two months. This event inspired the independence movement in Ecuador, and in 1822, the country finally gained freedom and separated from Gran Colombia, forming the Republic of Ecuador with Dr. José María Velasco Ibarra as its first national leader. After its independence, Ecuador experienced a period of political instability marked by frequent changes to its constitution and government. In the 19th century, the Republic of Ecuador faced territorial conflicts with Peru, which were resolved through the Rio Protocol in 1942. In the 20th century, Ecuador underwent several political changes, including revolutions and social reforms (BBC News, 2024).

Since its independence, the Republic of Ecuador has faced various domestic challenges that have affected its political, economic, and social conditions. These challenges were driven by changes in government and the constitution, resulting from political factional conflicts between conservative and liberal groups. In addition, Ecuador's economy has been heavily dependent on agricultural exports, particularly cocoa and coffee. The lack of industrialization and reliance on the agricultural sector make the Ecuadorian economy vulnerable to global price fluctuations and natural disasters. Furthermore, social issues such as discrimination against indigenous groups and people of African descent, as well as limited economic access, have led to internal conflicts and protests against government policies perceived as harmful to indigenous communities, in light of the high poverty rates (Holden & Zolove, 2011).

The Republic of Ecuador's economy is based on crude oil production and the export of bananas, shrimp, and other primary agricultural products. However, the economy experienced a severe downturn in 1999, when an economic and financial crisis sent global oil prices into a shock, resulting in an annual inflation rate of 52.5% and a currency devaluation of 65%. In 2000, this situation prompted the government of Jamil Mahuad to implement a dollarization policy, replacing the Sucre as the official currency, as a strategy to restore domestic economic stability. The dollarization policy, coupled with rising global oil prices, strengthened Ecuador's economy, leading to a 5.4% increase in GDP in 2001 (U.S. Department of State, 2022).

II. LITERATURE REVIEW

Academic studies on foreign aid indicate that aid flows not only affect short-term economic development but also shape the structural dependency of recipient countries on donors. Several empirical studies have found that foreign aid can serve as a complement to domestic investment and stimulate growth under certain conditions; however, in the context of developing countries, it often has the potential to create fiscal and external dependency if not accompanied by strong institutional reforms (Effects of foreign aid on the recipient country's economic growth, 2020). This dependency arises when aid replaces rather than strengthens domestic resources, reducing incentives for sustainable national revenue mobilization. Meanwhile, literature on international economic policy emphasizes the complexity of the relationship between foreign aid and economic sovereignty. Aid is often accompanied by conditions that can constrain the recipient country's policy space, making it more reliant on donor requirements in setting its national development agenda. In a geopolitical context, aid allocation preferences are influenced by donors' strategic objectives, including the creation of economic and political influence networks, rather than solely by development goals (The geopolitics of foreign aid from the Cold War to Globalization, 2025).

The dollarization policy adopted by Ecuador in 2000 was a response to a crippling macroeconomic crisis, including hyperinflation and a banking crisis. The adoption of the US dollar as the official currency was intended to stabilize inflation and strengthen market confidence, but it meant that the country gave up independent monetary policy instruments, such as exchange rate and interest rate management (Dollarization in Ecuador: 2000–2024, 2025). Thus, the context of dollarization narrowed the domestic policy space that would normally allow the country to respond to external shocks without relying on foreign aid or international credit. Research on dollarization shows that using a foreign currency increases economic interdependence between Ecuador and the United States. Castillo-Ponce, Truong, and Rodriguez-Espinosa (2021) found that after dollarization, the correlation between Ecuadorian economic variables and the US economy increased, particularly in the financial sector, indicating that the use of a shared currency promotes market integration and dependence on the economic cycles of the currency-issuing country.

The implications of this policy are closely related to external dependency, which is reinforced by dollarization. Without monetary instruments, the country becomes more vulnerable to changes in global economic policies, such as U.S. monetary policy, commodity price fluctuations, and international market conditions. In such situations, the need to obtain external resources—whether through bilateral aid, multilateral loans, or foreign investment—becomes increasingly important to maintain economic stability and domestic growth (Full dollarization versus monetary union: the case of Ecuador, 2023). Several studies also indicate that dollarization provides short-term stability but does not necessarily resolve structural economic problems. This policy often only mitigates the symptoms of a crisis without addressing underlying issues such as fiscal weakness and economic structure, leaving the country in a position where it continues to require external support when facing new economic pressures. This situation reflects the interaction between dollarization and foreign aid as factors that can deepen recipient countries' long-term dependency on external resources.

III. METHODOLOGY

The theoretical methodology in the study on "The Impact of Foreign Aid on the Dependency of Recipient Countries: The Dollarization Policy of the Government of the Republic of Ecuador" is based on the understanding that international relations within the context of the global economy cannot be separated from power structures and interaction patterns that create long-term dependency for developing countries. Dependency theory serves as the main framework to examine how foreign aid is not only a transfer of capital but also a political and economic instrument that shapes asymmetrical relationships between donor and recipient countries. From this perspective, foreign aid is understood as a mechanism that can reinforce dependency structures and limit the policy autonomy of developing countries (Kabonga, 2017). This concept of dependency becomes even more relevant when linked to Ecuador's dollarization policy. Dollarization, adopted in 2000, is understood as a structural decision that eliminated the country's ability to control domestic monetary policy. Within the framework of dependency theory, replacing the national currency with the US dollar creates a new pattern of economic and policy dependency on the Federal Reserve. Several studies indicate that countries that adopt dollarization tend to experience increased sensitivity to external shocks and lose monetary instruments as tools for economic stabilization (Connolly, 2024).

To strengthen the analysis, this study also employs the theory of complex interdependence by Keohane and Nye. Unlike dependency theory, which is more critical of unequal structures, complex interdependence theory emphasizes that, in a globally interconnected world, states can be mutually dependent across economic, political, and security domains. However, this interdependence is not always symmetrical; relationships influence each other but do not necessarily yield balanced benefits. This theory helps explain how Ecuador operates within a broader international economic network while receiving foreign aid and implementing dollarization (Keohane & Nye, 1977). In the context of foreign aid, complex interdependence theory shows that, despite the potential for structural dependency, aid can also serve as an instrument for economic integration and macroeconomic stabilization. However, such stabilization can create deeper forms of interdependence, especially when the recipient country adjusts its economic policies to align with donors' or international institutions' preferences. This is evident in the case of Ecuador after dollarization, when many fiscal and structural policies became more closely linked to the recommendations of international institutions such as the IMF and the World Bank, which are also the main sources of aid and international credit (Arévalo & Martín, 2021).

This theoretical methodology further operationalizes key concepts such as foreign aid, economic dependency, and policy autonomy as interrelated analytical variables. Foreign aid is understood as an independent variable that can influence dependency through technical or political mechanisms. Economic dependency is analysed through indicators such as sensitivity to donor policies, fiscal composition, and reliance on foreign currency. Meanwhile, dollarization is treated as an intervening variable that reinforces or modifies the structure of dependency (Castillo-Ponce et al., 2021). In constructing these theoretical relationships, this study employs an analytical model linking foreign aid flows, the adoption of the US dollar as currency, and the resulting long-term dependency. This model follows the analytical tradition in international political economy, which seeks to explain how global structures shape the domestic policy choices of developing countries. The framework also emphasizes that monetary policy changes, such as dollarization, cannot be separated from a country's position in the global economy and its historical fiscal and monetary dependencies.

In addition, the theoretical methodology of this study also employs an institutional approach to examine how foreign aid and dollarization affect the structure of domestic economic institutions. Several studies indicate that foreign aid flows can reduce incentives to build domestic fiscal capacity, thereby prolonging a country's dependence on external aid (Olaoye & Akinyele, 2025). While dollarization limits monetary policy space, dependency on aid can constrain a country's ability to maintain independent fiscal policies, creating a mutually reinforcing cycle of dependency. This theoretical methodology integrates three major frameworks: dependency theory, complex interdependence, and institutional theory, to build a comprehensive analysis of how foreign aid and dollarization influence the dependency of recipient countries. By using this combined approach, the study can explain dependency not only as a linear economic relationship but also as a political, historical, and institutional construction shaped by global structures and domestic policy choices. This theoretical approach provides a strong foundation for analyzing Ecuador's position in the international economic system following the adoption of the dollar and continued receipt of foreign aid.

IV. MAIN DISSCUSSION

In The Process Of Ecuador's Development, The Country Has Sought To Build Sustainable Economic And Social Foundations. According To The World Bank Report "Ecuador: Growing Resilient For A Better Future", The Current Development Strategy Priorities Of Ecuador Focus On Three Strategic Issues:

1. Responsible management of natural resources to ensure that resource exploitation is conducted sustainably in support of long-term economic growth
2. Enhancing the competitiveness of the private sector to promote innovation and investment, thereby creating new jobs and increasing productivity
3. Developing growth potential sectors such as agriculture, formal mining, and tourism.

The Ecuadorian government has worked to increase the productivity and added value of agricultural products such as cocoa, bananas, and cut flowers (roses). In the tourism sector, the government has developed cultural sites in the Galapagos Islands, Quito, and Cuenca (World Bank Group, 2024). These policies have significant potential to reduce Ecuador's economic vulnerability to global oil price volatility.

In pursuing these development priority issues, the Government of Ecuador has utilized opportunities for foreign aid to support their successful implementation. Ecuador has faced various challenges that have led to budget constraints and significant barriers to independently implementing development initiatives. This context prompted Ecuador in 2020 to approve an Extended Fund Facility (EFF) agreement provided by the International Monetary Fund (IMF) in the form of a USD 6.5 billion loan to support domestic economic development and stability, as well as to promote sustainable growth (International Monetary Fund, Western Hemisphere Department, 2023). This agreement has been implemented gradually since 2019, during which Ecuador received a total of USD 4.2 billion over three years to enhance competitiveness, create employment, strengthen fiscal sustainability, protect vulnerable groups, and improve transparency and anti-corruption measures (International Monetary Fund, 2019). In 2024, the IMF approved a 48-month EFF agreement totaling USD 4 billion to further strengthen fiscal sustainability, protect vulnerable populations, maintain economic stability, and promote sustainable growth (International Monetary Fund, 2024).

These foreign loans have had a significant impact on Ecuador's domestic development. According to the IMF evaluation report, the EFF agreement between Ecuador and the IMF has resulted in improved fiscal stability and financial management. Fiscal governance improvements include reducing budget deficits and lowering public debt through subsidy reductions and control of public expenditures. Economic growth has facilitated increased allocations for development projects in infrastructure, education, health, and other sectors. In terms of social protection, structural reforms have been implemented through food and education subsidies to support inclusive growth. Access to basic services for vulnerable populations has improved, potentially reducing poverty and social inequality. Additionally, energy subsidies have been reduced, and budget allocations have been redirected toward investments in renewable energy and infrastructure, such as solar and wind power plants, to reduce dependency on crude oil (International Monetary Fund, Western Hemisphere Department, 2024). This energy diversification also helps mitigate climate change and create new employment opportunities for local communities.

Although the IMF's assistance has had a significant impact on Ecuador's development, particularly economic development, it has also indirectly contributed to long-term dependence on the United States. Referring to Dos Santos' dependency theory, dependency is a form of unequal relational relationship between developed and poor countries in the context of development between the two actors. Dependency refers to the relationship between a dominant country (developed) and a dependent country (developing), creating reliance on foreign investment and aid in reducing the economic autonomy of developing nations. Dos Santos defines dependency as a situation in which a country's economy is influenced by the development and economic expansion of another dominant country. In this relationship, dominant countries can develop independently, while dependent countries can only develop as a reflection of that expansion, with either positive or negative effects on their growth. According to him, there are three forms of new dependency that can arise due to the demands of international commodity and capital markets in a country's economic development: (1) industrial development relies on exports so that foreign currency can purchase inputs used by the industrial sector, (2) development is highly influenced by fluctuations in the balance of payments, and (3) industrial development is heavily affected by technological monopolies held by imperialist countries (Dos Santos, 1970). Foreign aid then becomes an important instrument for covering balance-of-payments deficits and financing development to stimulate investment and economic growth.

This can be seen in the implementation of Ecuador's dollarization policy. The economic crisis of the 1990s—including high inflation, foreign debt crises, dependence on oil exports, and a banking crisis—prompted Ecuador to adopt the dollarization decision in 2000. This decision was made after the government could no longer maintain stability in Sucre and sought to avoid hyperinflation. Furthermore, dollarization was implemented to increase foreign investor confidence in Ecuador. The dollarization policy addressed the challenges of the economic crisis by stabilizing prices through reduced inflation, improving the investment climate through a strengthened monetary system using the United States dollar (USD), lowering interest rates to encourage consumption, and providing easier access to financial markets by eliminating exchange-rate risks. However, the negative side of this policy has created long-lasting effects for Ecuador. The country gradually became dependent on the USD after losing sovereignty over its monetary policy. With dollarization, the nation's monetary policy is determined by the United States Federal Reserve, meaning Ecuador relinquished full control over monetary policy and exchange rates. This has created new vulnerabilities to changes in U.S. interest rate policies and currency fluctuations. In the long term, Ecuador cannot adjust its exchange rate policy during an economic crisis, resulting in a strong dependence on the United States (Berg & Borensztein, 2000).

Ecuador is considered one of the United States' strategic partners in economic, political, social, and environmental terms. The two countries are geographically close, so instability in Ecuador can affect domestic conditions in the United States. Therefore, the U.S. often provides financial, technical, and diplomatic support to ensure political stability and prevent economic crises in Ecuador. Through USAID in 2013, the United States also provided annual funding of USD 32 million for development, although tensions arose over allegations of U.S. domestic interference in Ecuador (Antara News, 2013). The United States is also a key supporter of the approval of the IMF's EFF assistance program for Ecuador. Ecuador's dependency on the United States cannot be entirely blamed. Considering Ecuador's domestic conditions and the financial crisis affecting almost all countries, the United States, less directly affected, offered assistance to Ecuador through the IMF.

Recognizing its strong dependency on the United States, Ecuador has gradually begun to open access to South-South cooperation for economic development through aid and new market access. In 2019, Indonesia and Ecuador actively established trade and investment relations through the Working Group on Trade and Investment. This forum discussed market access, trade facilitation, customs procedures, and priority investment sectors, aiming to enhance trade relations, which had grown from USD 44.2 million in 2007 to USD 96.6 million in 2011 (Antara News, 2023). Through this cooperative framework, the trade volume between the two countries increased from USD 44.2 million in 2007 to USD 96.6 million in 2011 (Antara News, 2012). In addition, Ecuador also established a partnership with the People's Republic of China (PRC) in January 2023 through a free trade agreement. This agreement is expected to boost Ecuadorian exports of agricultural products such as shrimp, bananas, cocoa, and coffee to the Chinese market.

This agreement provides preferential access for Ecuadorian products to the world's largest market and allows Ecuador's industries to obtain machinery and inputs at lower costs. Through this partnership, the PRC provides support in market access, technology, infrastructure investment, and health assistance, which, collectively, can strengthen the country's economy (Metro TV News, 2023). Although the cooperation framework with the PRC provides many benefits for Ecuador's development, the aid also carries new risks, particularly the increase in Ecuador's external debt to the PRC, which exceeded USD 18 billion between 2010 and 2020. Most of the PRC-funded projects were financed through loans, many of which were repaid with crude oil as collateral (The Dialogue & Boston University Global Development Policy Center, 2024).

Foreign aid is an important instrument for accelerating national development in any country, including Ecuador. However, based on the conditions experienced by Ecuador, several conclusions can be drawn, including:

1. Foreign Aid as an Instrument for Short-Term Development
   Ecuador's experience demonstrates that foreign aid can provide a significant boost to economic stability, infrastructure development, and social protection in the short term. Aid from international institutions such as the IMF and major donor countries helps mitigate the impacts of economic crises and enhances the fiscal capacity of the recipient country.
2. Potential Risks of Long-Term Dependency
   Although beneficial, foreign aid also carries the risk of structural dependency. In the case of Ecuador, the inflow of external aid combined with the dollarization policy has made the country increasingly dependent on U.S. economic policies, particularly through the use of the U.S. dollar as its official currency. This underscores the importance of long-term strategic planning to reduce dependency.
3. Dollarization as a Factor Strengthening Dependency
   The dollarization policy implemented in Ecuador enhanced short-term monetary stability but simultaneously removed the country's control over domestic monetary policy. The lesson learned is that adopting a foreign currency can narrow national policy space, so recipient countries need to balance economic stability with monetary sovereignty.
4. The Need to Diversify Aid Sources and Cooperation Partners
   A high reliance on a single donor or international institution increases a country's vulnerability to changes in external policies. Ecuador has begun establishing partnerships with other countries, such as the PRC and Indonesia, highlighting the importance of diversifying cooperation to reduce the risk of dominance by a single party.
5. The Importance of Focusing on Strengthening Domestic Capacity
   The main lesson learned is that foreign aid should be directed toward strengthening domestic capacity, such as developing industry, infrastructure, and technology. In this way, recipient countries can enhance economic self-reliance and gradually reduce dependence on external assistance.
6. Exit Strategy as a Strategic Necessity
   Ecuador's experience shows that without an exit strategy from dependency on foreign aid, a country becomes vulnerable to global economic shocks. The lesson learned is that long-term planning should include developing domestic resources and sustainable fiscal policies to ensure economic self-reliance.

The dollarization implemented by the Republic of Ecuador in 2000 was a response to the severe economic and monetary crisis that hit the country in the late 1990s. This crisis was characterized by hyperinflation, the devaluation of the national currency, the Sucre, and the failure of the banking system, leading to a loss of public confidence in domestic financial institutions (Berg & Borensztein, 2000). Dollarization was seen as a solution to stabilize the economy, reduce inflation, and increase foreign investor confidence. However, this decision also caused the country to lose control over monetary policy, creating structural dependency on U.S. economic policies (Connolly, 2024). Ecuador's economic dependence on the U.S. dollar narrowed its domestic policy space. Without the ability to issue its own currency or adjust interest rates, Ecuador had to align its fiscal policies with external pressures. This strengthened the position of donors and international institutions, such as the IMF, in shaping the country's macroeconomic policies (Full dollarization versus monetary union: the case of Ecuador, 2023). Empirical studies show that adopting the U.S. dollar as the official currency increased economic interdependence between Ecuador and the United States, particularly in the financial sector, and created additional risks amid global economic fluctuations (Castillo-Ponce, Truong, & Rodriguez-Espinosa, 2021).

In addition, structural factors driving dollarization include Ecuador's reliance on oil, cocoa, and banana exports. Fluctuations in global commodity prices destabilized government revenues and widened the fiscal deficit. In this context, the U.S. dollar was seen as an external stabilizer to maintain currency value and boost market confidence (Holden & Zolov, 2011). However, reliance on a foreign currency and international aid also poses long-term risks, such as fiscal vulnerability to changes in global oil prices and U.S. monetary policy. Dollarization also has social and political implications. The government's reduced capacity to implement an independent monetary policy affects the allocation of subsidies, development projects, and social protection programs. The government must align fiscal policies with donor and international institution pressures to maintain economic stability, which can sometimes trigger social conflicts and protests from local communities (Arévalo & Martín, 2021). This demonstrates that economic dependency is not only financial but also affects political sovereignty and the government's capacity to respond to domestic needs.

From the perspective of dependency theory, dollarization illustrates how foreign aid and global economic integration can create an asymmetric relationship between donor and recipient countries. External aid and support can promote short-term growth, but if not accompanied by the development of domestic capacity, it can deepen structural dependency (Dos Santos, 1970). Ecuador serves as an example of a country that achieved macroeconomic stability through the U.S. dollar, yet lost the policy tools needed to adjust its economy to external shocks. Overall, Ecuador's experience shows that dollarization is a double-edged sword. While it stabilizes the economy in the short term and enhances investor confidence, it also creates long-term dependence on another country's currency and economic policies. The lesson for developing countries is the importance of building domestic capacity, diversifying the economy, and developing an exit strategy from external dependency so that economic stability does not rely solely on foreign aid or a foreign currency (Olaoye & Akinyele, 2025).

V. CONCLUSIONS

Foreign aid has become a primary instrument used by the Republic of Ecuador to support its domestic development activities. This is evident in the country's economy, which began to recover gradually following the 1990s economic crisis. However, the high dependence on foreign aid, particularly from the United States and the IMF, has made Ecuador economically non-sovereign. Its monetary and exchange rate policies are heavily dependent on U.S. policies through the dollarization program. While the economy has recovered, the debt burden has increased, posing challenges that must be addressed going forward. Although Ecuador has achieved de facto and de jure independence, the dollarization policy effectively placed the country under a form of new economic colonialism, creating full dependence on the U.S. dollar. A similar dynamic is evident in Ecuador's cooperation with the People's Republic of China (PRC). While this partnership provides access to new markets and economic growth, it also creates new debt obligations, further increasing Ecuador's future financial burden. Foreign aid indeed serves as an important instrument for development, especially when a country faces fiscal constraints in financing its domestic development. However, it must be recognized that the dependency created by foreign aid can sometimes produce short-term positive effects while burdening a country in the long term if external debt continues to increase. In the case of the Republic of Ecuador, this situation is exacerbated by the dollarization policy. If the value of the U.S. dollar fluctuates, the country lacks economic autonomy to determine its long-term national policies and direction. Given its potential, Ecuador needs to gradually build a conducive domestic environment to develop domestic industries by relying on its natural resources. The aim is to create economic self-reliance, which can be achieved gradually if foreign aid is focused on infrastructure development and technology to support domestic industries. If the Republic of Ecuador does not immediately develop an exit strategy to address its reliance on foreign aid, this situation could leave the country more economically vulnerable, especially if another economic crisis occurs or global oil prices become unstable again. Ecuador needs to consider opening economic partnerships with other countries to break its dependency chain on the United States and the IMF, as has already been done with China (PRC) and Indonesia. However, it is important that such partnerships are designed to avoid additional foreign debt and instead focus on increasing export volumes that can support economic growth. The economic surplus generated by higher export volumes can then be used by Ecuador to finance domestic development and gradually reduce its reliance on foreign aid. Economic improvements rooted in enhanced domestic capacity could eventually enable Ecuador to return to using the Sucre as its national currency and reduce its reliance on the U.S. dollar.

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