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**Financial inclusion policy in Ecuador:
Role of the Central Bank towards
economic growth and job creation**

Daniela Arias

Employment and
Labour Market
Policies Branch

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Preface

The primary goal of the ILO is to contribute, with member States, to achieve full and productive employment and decent work for all, including women and young people, a goal embedded in the ILO Declaration 2008 on *Social Justice for a Fair Globalization*,¹ and which has now been widely adopted by the international community.

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¹ See http://www.ilo.org/public/english/bureau/dgo/download/dg_announce_en.pdf

² See <http://www.ilo.org/employment>.

Foreword

The basic premise of this study is that promoting financial inclusion is one of the most effective ways in which a central bank can support economic growth and productive employment creation. The study shows that the scope of the government's financial inclusion programme in Ecuador is wide and varied. It then proceeds to encapsulate the main objectives of the financial inclusion policy and identify the main actors involved in its execution. The recent revamping of the Central Bank of Ecuador's financial inclusion programme is promising. The effects of this revamped programme on target groups would need appropriate scrutiny once more data becomes available.

Despite this cautious judgement, the study highlights how, in the recent past, the Bank has been indirectly implementing its financial inclusion policies through allocation of funds to other public institutions, such as CONAFIPS. The results obtained in the six years during which CONAFIPS has been operating are quite encouraging and the evidence presented here suggests that there has been an improvement in access to credit, especially by the popular and solidarity-based sectors. These sectors are the main target of government's financial inclusion programmes.

Finally, the study notes that current developments in monetary and financial policies and proposed changes to the monetary code create some uncertainty over the future of the government's financial inclusion policy. Further research on the implications of changes to the monetary code is needed.

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1 Introduction

Over the last seven years, Ecuador has experienced important changes in the dynamics of its economy. The current administration has steered the country into a path of sustained growth and development through policies that have been designed to stimulate various sectors of the economy. It has also developed a comprehensive National Plan that targets several social issues such as access to housing, education, health services and other basic needs.

Under the new Constitution approved in 2008, Ecuador became one of the more than 50 countries that have taken steps toward the development and implementation of active policies and strategies for financial inclusion. The financial inclusion programme is designed to extend access to formal channels of finance to the rural population and the poor who have previously been excluded from such services. The goal is to enable the poor to benefit from the tools of finance: saving and borrowing, building up assets and investing in education, skills, and entrepreneurship, which ultimately helps improve their livelihoods (World Bank, 2013).

In this regard, the current administration began by making some important changes, specifically; a new Constitution was drafted to address several issues. Alongside the public and private sectors, a new sector called the popular and solidarity-based sector was created. This sector, created with the intention to provide financial services to micro, small and medium-sized enterprises, comprises credit unions, associations or charitable organizations, societies and community banks, and savings banks. The Government also provides special treatment to this sector on condition that its institutions promote the development of the popular and solidarity-based economy³.

Secondly, the Constitution was amended to allow the Executive branch to take over control and management of the Central Bank of Ecuador (BCE). In this way, through the BCE, central government became responsible for the development and implementation of monetary policies, as well as regulation of the financial sector. For example, under instructions from the Government, the ECB has been controlling and regulating the lending rate, which decreased from 10.26% in May 2007 to 8.19% in June 2014.

Other important policies related to financial inclusion that have been implemented by the current administration are the creation of the *Programa de Finanzas Populares*, a popular finance programme aimed at extending credit to smaller financial cooperatives in order to increase their capacity for lending to small businesses; capital investment in social programmes and infrastructure in key sectors, and more effective tax collection.

The Government's increased spending on social programmes, housing, education, and the expansion of conditional cash transfer (CCT) programmes such as the human development bond has resulted in a decrease in the poverty rate of 10.3 percentage points from 37.6% in December 2006 to 27.3% by December 2012⁴. Similarly, extreme poverty has also seen an important reduction, falling from 17% in December 2006 to 11.6% by December 2012. These and other statistics, discussed below, reflect not only the positive impacts of the different government policies implemented in recent years, but also the strong performance of the economy in terms of GDP growth.

³ Constitution of the Republic of Ecuador (2008), Art. 311

⁴ Ecuadorian National Institute of Statistics and Censuses (INEC)

The BCE's definition of the financial inclusion programme and precepts were approved in March 2012. It was formalized after the success of the remittances programme in which recipients of remittances were offered a formal, inexpensive and safe channel to receive their money, thus making these transfers part of the formal financial system. The Central Bank's financial inclusion programme is planned to work at three levels: macro, meso and micro. This provides a platform that will provide a strong legal framework and proper supervision of the effective functioning of the policies; a system that guarantees the rights of consumers through the implementation of inclusive payment systems; and expanded coverage to reach rural zones and city suburbs through mobile payments and transactions (Arregui, Guerrero, Espinosa, Murgueytio and Focke, 2012).

In general, financial inclusion programmes are a key issue in government policies because access to finance, or the lack of it, not only indicates the proportion of the population that benefits from financial services, but also serves as an indicator of inequality, vulnerability of certain sectors, imperfect information and market failures. As the World Bank argues in its 2014 Global Financial Report, the goal behind financial inclusion is not to provide unlimited access to credit for the sake of inclusion. The goal is to provide access to credit and financial services to the sectors of the economy and individuals who have been involuntarily excluded from the formal financial system due to factors such as discrimination, lack of information and price barriers, with the objective of incorporating them in the system, helping them maximize the returns on their rural and local economies and, ultimately, stimulating job creation.

The aim of this paper is to examine the policies that have been developed and adopted by the Ecuadorian Government and implemented by the Central Bank of Ecuador in order to assess their effectiveness in contributing not only to economic growth, but also to employment creation.

In this sense, key aspects of financial inclusion are examined, such as the effects of better access of individuals and small enterprises to capital for entrepreneurial activities on the development of local economies; the positive effects of an increase in savings deposits on the formal financial system (i.e. enhanced security of users' savings, disincentives to resort to informal moneylenders or "loan sharks", reduction in transaction costs, etc.); the effects of access to finance via mobile devices and mobile banking, especially in remote areas; the effects on expenditure patterns; and the effects of financial inclusion on social inclusion.

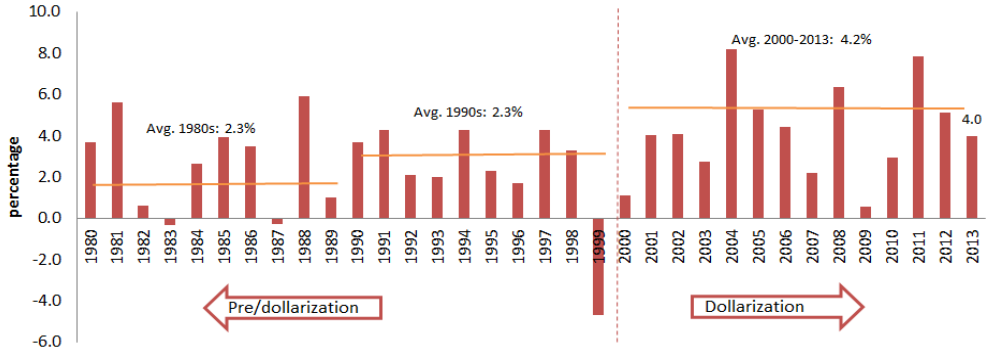
The remainder of this paper is divided into eight sections. Section 2 gives an overview of the Ecuadorian economy and labour market in recent years. Section 3 presents a review of the literature on the linkages between financial inclusion, economic growth and employment creation. Section 4 summarizes the ECB's policies on growth and employment, followed in Section 5 by a presentation of the ECB's financial inclusion policy at the macro, meso and micro level, and the role of such policies on remittances and the Human Development Bond. It also gives an overview of the roles of other public institutions that target financial inclusion, such as the National Corporation for Popular Finance (CONAFIPS). Section 6 presents the main data and information on financial access. Section 7 presents the current developments in monetary policy and the Ecuadorian political scene and, in conclusion, Section 8 evaluates the progress of the financial inclusion policies and presents some closing remarks.

2 Recent Trends

Since President Correa took office in 2007, the Ecuadorian economy has experienced the positive effects of the Government's policy changes. On average, the economy has grown at a rate of more than 4% over the last five years, with the exception of 2009 and 2010, when it slowed as a consequence of the financial crisis. In comparison with the previous decade, average GDP growth was 2.3 percentage points higher between 2000 and 2013 at 4.2% compared to a meagre 2.3% average between 1990 and 1999 (see Figure 1). As will be explained in more detail below, the poor performance of the Ecuadorian economy in the 1990s was primarily due to the impact of several external shocks and political instability, which ended in the overthrow of the incumbent President, and setting Ecuador on the path to dollarization.

In terms of the composition of GDP by expenditures, household consumption is the largest component representing more than 60% of GDP, and has remained quite stable since 2007.

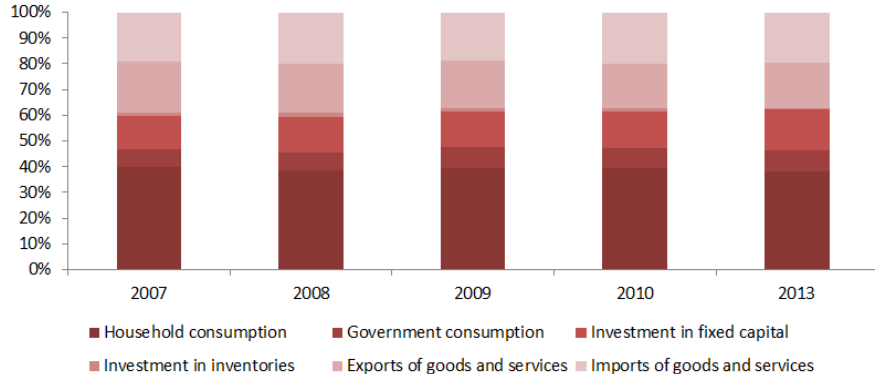
Figure 1: GDP Growth, 1980-2013



Source: Central Bank of Ecuador Statistics. Author's own preparation

In contrast, government consumption has increased since the beginning of the current administration from 10.9% in 2007 to 13.4% in 2013, while investment in fixed capital grew the most from 20.8% of GDP in 2007 to 26.6% in 2013, the biggest change in the composition of GDP over the six-year period. As shown in Figure 2, exports and imports remained fairly stable overall between 2007 and 2013, although the share of exports in GDP decreased slightly from 31.9% in 2007 to 29.4 in 2013, while that of imports increased from 30.7% to 32.1% in the same period, despite the strict restrictions on imported goods put in place in the last few years.

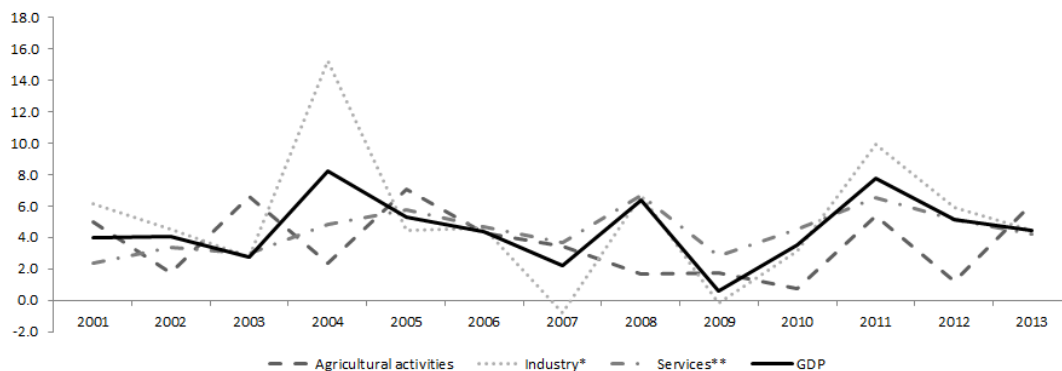
Figure 2: Composition of GDP and growth, 2007 – 2013



Source: Central Bank of Ecuador Statistics. Author's own preparation.

Lastly, in terms of sectoral GDP growth, Figure 3 shows that the industrial sector experienced the largest growth since the current administration took office, with a 5.3 percentage point increase between 2007 and 2013, reflecting the Government's efforts to encourage domestic industries and manufacturing. As a result, the industrial sector's share of total GDP increased to 35% in 2013. In contrast, agricultural activities grew at a slower pace, from 3.4% in 2007 to 6.2% in 2013, contributing 8.4% of total GDP. As for the service industry, although it represents more than 50% of total GDP, it experienced only a slight change of 0.6 percentage points in the 6-year period.

Figure 3: GDP growth by aggregate sectors, 2001-2013



Note: *Industry includes mining and quarrying; manufacturing; electricity, gas and water supply; and construction. **Services include wholesale and retail trade; accommodation and food services; transport, storage and communications; financial and insurance activities; professional and technical activities; education, health and social services; public administration and defence; household activities; and other activities.

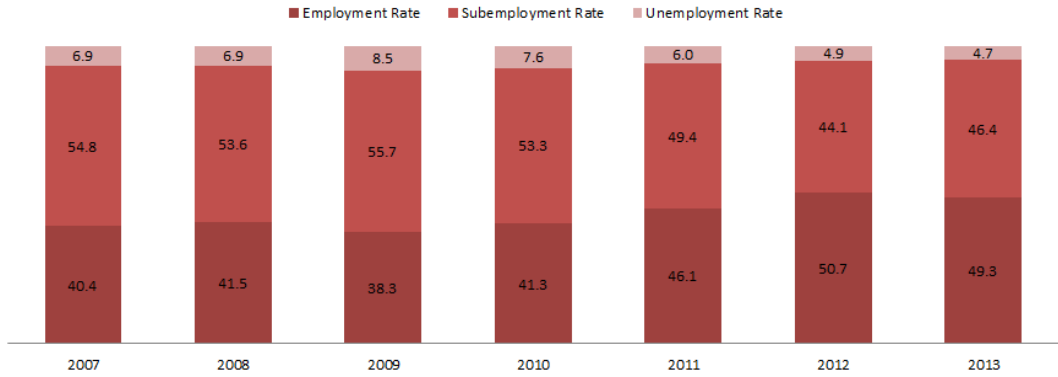
Source: National Accounts, ECB. Author's own preparation.

2.1 Labour market and poverty

The gains from the development and growth of the Ecuadorian economy have also had a positive impact on the labour market which has seen an improvement in total employment over the past seven years. There has also been a systematic decrease in the unemployment rate⁵, from 6.9% in 2007 to 4.7% in 2013. This decrease is not only the result of a healthy economy but also the entry of the public sector into the labour market as a strong competitor to the private sector. In contrast to previous administrations, the current government has changed the dynamics of the labour market by demanding highly specialized workers, offering stable employment and competitive salaries. This has forced the private sector to step up and offer more attractive packages to attract young professionals. Similarly, as shown in Figure 4, the percentage of subemployed people declined significantly by almost 8 percentage points between 2007 and 2013, from 54.8% to 46.4%.

⁵ With the exception of 2009, in which there was an increase as a result of the financial crisis.

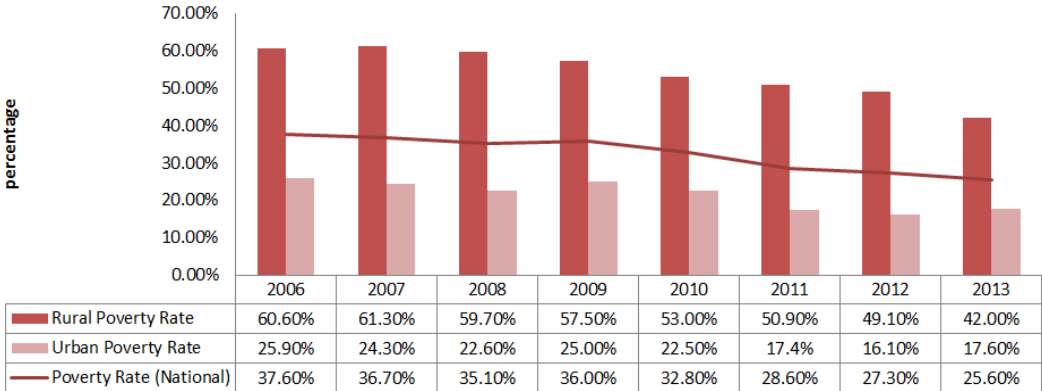
Figure 4: Evolution of the Labour Market, 2007-2013



Source: National Institute of Statistics and Censuses (INEC). Author's own preparation.

The improvement in the labour market has also led to improved wage and salary levels. In 2013, the nominal basic/minimum monthly salary stood at 340.5 USD, a 70% increase compared to its 2007 level of 196.3 USD per month. The increase in wages and job opportunities has, as a result, allowed more Ecuadorians to escape poverty and enter the middle class. As shown in Figure 5, the poverty rate has decreased substantially throughout the Correa administration, an indication of the efficiency of the economic and social policies implemented by this Government, the increased expenditure on health and education, and the expansion of social programmes and cash transfers, such as the Human Development Bond.

Figure 5: Poverty rates, 2006-2013



Source: National Secretariat for Planning and Development (SENPLADES). Author's own preparation

Poverty reduction is also associated with better access to health services, education, housing, etc., which has been fostered by social expenditure and investment. With regard to education, Table 1 shows, albeit indirectly, the positive effects of increased expenditure on education; the national (urban/rural) child labour rate decreased from 8% to 2.6% between 2007 and 2013, indicating that more children are now able to stay in school instead of having to work.

Table 1: Child Labour (ages 5-17), 2007-2013

Year	National avg.	Rural	Urban
2007	8.0	15.3	3.6
2008	5.7	10.1	2.9
2009	5.4	11.1	1.9
2010	3.8	7.7	1.4
2011	2.7	5.7	1.0
2012	3.2	6.4	1.3
2013	2.6	5.7	0.8

Source: National Secretariat for Planning and Development (SENPLADES). Author's own preparation.

Another mechanism that has contributed to poverty reduction is the incentives programme for productive ventures and entrepreneurship by microenterprises from the popular and solidarity-based economy. According to available statistics, the economy generated 6,406,694 jobs in 2008, of which 61% in the popular economy subsector⁶, while the remaining 39% was split between the private and public subsectors (33% and 6%, respectively). A year later, the economy added 92,568 new jobs; 64% of the total number of jobs was generated in the popular economy subsector⁷, reflecting the importance of the popular and solidarity-based sector in the development of the economy and the positive consequences of the recognition of this sector in the 2008 Constitution.

In terms of the sectoral distribution of jobs, wholesale and retail trade was the main contributor to job creation, while repair of motor vehicles accounted for 22.1% of jobs, followed by agricultural crops (13.1%), livestock farming and animal products (8.4%), construction (8.1%), and growing of bananas, coffee, and cocoa (6.9%) (See Table 2 below). The table also shows, in the case of agricultural activities (agriculture, farming and fishing) that 32% of employment opportunities were in the primary sector, which employed 1.4 million people. In other words, one out of three people from the Popular Economy worked in agricultural activities in 2009.

⁶ The 2009 Household Survey does not allow differentiation of the Solidarity-based sector, and thus it is not reported.

⁷ Ministry of Economic and Social Inclusion (MIES) (2011-2013)

Table 2: Employment in the popular economy by activity, 2008

Activity/Sector	Employees	%
Wholesale and retail trading	972,544	22.1
Growing of crops (wheat)	576,196	13.1
Farming of animals, animal products	367,640	8.4
Construction	356,072	8.1
Growing of bananas, coffee, cocoa	301,185	6.9
Restaurants and bar services	227,593	5.2
Household activities	216,526	4.9
Transport and storage	159,023	3.6
Manufacture of wearing apparel	156,404	3.6
Professional, technical and technical activities	148,246	3.4
Arts, entertainment and recreation	111,805	2.5
Repair of motor vehicles and motorcycles	82,748	1.9
Human health and social work services	82,725	1.9
Manufacture of furniture	68,341	1.6
Agriculture and fishing	52,795	1.2
Growing of crops	40,287	0.9
Oil and industrial related growing	37,531	0.9
Manufacture of baking products	41,578	0.9
Manufacture of leather and related products	25,666	0.6
Support activities to agriculture	22,430	0.5
Forestry and logging	21,015	0.5
Processing and preserving of meat	23,501	0.5
Manufacture of wood and of products of wood and cork	23,037	0.5
Information and communication	19,887	0.5
Education (private)	15,853	0.4
Manufacture of fabricated metal products, machinery and equipment	15,450	0.4
Manufacture of dairy products	13,863	0.3
Mining	13,525	0.3
Manufacture of soft drinks, mineral waters and other bottled waters	13,121	0.3
Manufacture of glass and glass products	13,026	0.3
Manufacture of non-metallic mineral products n.e.c	12,319	0.3
Manufacture of paper and paper products	10,633	0.2
Other manufacturing	9,678	0.2
Manufacture of chemicals and chemical products	7,346	0.2
Manufacture of grain mill products	7,698	0.2
Accommodation	4,908	0.1
Fishing and aquaculture	5,377	0.1
Manufacture of sugar	4,843	0.1
Manufacture of other food products	3,618	0.1
Manufacture of cocoa, chocolate and sugar confectionery	3,605	0.1
Manufacture of transportation equipment	2,772	0.1
Manufacture of grain mill products	2,655	0.1
Real estate activities	6,523	0.1
Financial intermediation	3,783	0.1
Other	88,093	2.0
Total	4,393,464	100

Source: Ministry of Economic and Social Inclusion, Popular and Solidarity-based Economy Revolution Agenda, 2011-2013.

In general, therefore, the Ecuadorian economy performed well in the last seven years. The policies adopted by the Government have not only maintained economic growth but have also improved labour market conditions, creating jobs and helping people climb out of poverty. Furthermore the popular and solidarity-based sector is a key factor in the development of the cooperative and associative systems and plays an important role in terms of job creation. For this reason, as will be discussed below, empowering that sector by giving it more access to credit and developing more financially inclusive policies is a primary concern and objective for the Government.

3 Overview of the literature

There is a vast array of studies that have focused on the link between a structured financial sector and economic development. Several hypotheses have been put forward regarding the links between financial development and economic growth, and although there are some diverging theories, there is a general consensus that a country with a stronger financial system is more likely to enjoy higher economic growth than a country with a weak financial system or none at all. In addition, there has been renewed interest in the subject in recent years by policymakers and central banks alike as they recognize the importance of finance to growth. In 2010 the G20 launched the Global Partnership for Financial Inclusion with the task of promoting work on financial inclusion as well as the coordination and implementation of the Financial Inclusion Action Plan agreed at the G20 Summit in Seoul.

The link between the financial sector's strength and economic growth has been documented in several studies. The World Bank (1989), (2013), (2014), for example, has documented the positive relationship between well-functioning financial sectors and economic development through cross-country studies. In its 2014 Report, the World Bank finds that greater access to financial services for those who have been involuntarily excluded has a positive impact on poverty reduction, and economic and social development. It stresses the importance of developing viable strategies to broaden the reach of financial inclusion policies without compromising the country's financial stability.

Other studies have focused on the causal relation between financial development and growth. Levine and Beck (2000), for example, use two different econometric techniques: (1) GMM dynamic panel estimators and (2) a cross-sectional instrumental-variable estimator to examine whether financial intermediary development has an effect on economic growth. Their findings show that financial development has a significant positive effect on economic growth, and further suggest that countries with stronger legal frameworks that enforce contracts, back creditors, and have high accounting standards boost financial development and, hence, influence economic growth positively.

Dittus and Klein (2011) examine the potential of financial inclusion policies through the use of mobile devices for payment services in Kenya. The authors find that the use of technology (i.e. mobile phones) to support microfinance has been successful in Kenya particularly, since it has made it easier for the poor to manage their income by giving them access to payment services and reducing their reliance on less safe saving and money transportation methods. Furthermore, Dittus and Klein argue that such schemes can be successful as long as there is continuous improvement of the business models developed so that the services can be provided in a sustainable manner. They stress the importance of regulation in order to prevent financial instability and undesirable outcomes.

In Ecuador, conditional cash transfer programmes have been an important framework used by the Government to reach out and help the poor. The Human Development Bond (Bono de Desarrollo Humano) was created in 2003 with the objective of extending social protection to the population in the lowest income brackets. This programme, which benefits 1.6 million people in the country, has been implemented in a way that payments are made through a private bank network or the public development bank, Banco Nacional del Fomento (Samaniego and Tejerina, 2010) inherently widening the supply of financial services to the poor. Nevertheless, Samaniego and Tejerina find that despite strong demand for financial services, the use of such services was low among the recipients of the Human Development Bond due to the fact that the related payment programme had not yet been implemented as part of the financial inclusion policies developed by the ECB when the study was published.

Another area of interest in the literature on financial inclusion is the role of remittances. For most developing countries, remittances are an important part of their national income and, in many, the main source of capital inflows. Each year, millions of migrants send their earned wages to their families in their country of origin. Many of them do it through informal channels, such as a trusted traveller (usually truck drivers) or travelling friends or acquaintances, or even hide it in parcels. Migrants who send money through the traditional channels are usually better protected, yet their families sometimes have a hard time accessing the funds as they have to travel long distances to collect the money, and transaction costs are high. Nevertheless, as Toxopeus and Lensink (2007) argue, as more options have become available for migrants and the private banking sector has become more interested in the remittances market, remittance inflows have had a positive impact on financial inclusion through the increased use of banking services to transfer money. In turn, a major degree of financial inclusion has also had a positive effect on growth. In the case of Ecuador, this effect is of particular importance, as remittances are the second largest source of GDP growth, as well as the motivation behind the development of financial inclusion policies (see Arregui et al., 2012).

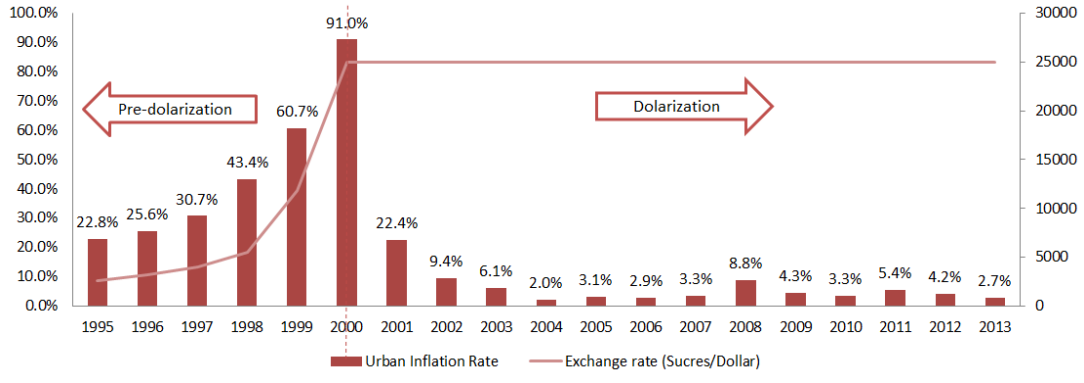
More recent studies show that through the creation of an alternative distribution channel of remittances for small Ecuadorian financial intermediaries, the Central Bank of Ecuador, through the Ministry of Economic and Social Inclusion (MIES) has incorporated about 300 credit unions into the national payments system so that these institutions can become distribution points for remittances at lower cost and in real time (Arregui et al., 2012.) This programme has increased the number of payment points across the country to 1000 and the number of recipients by 20 per cent (Arregui et al., 2012.) In addition to this, the programme has widened the user access to financial services as well as providing a wire transfer service for migrants who do not have a formal bank account abroad, reducing the use of informal channels and including this segment of the population in the formal financial system.

Lastly, the literature on the effects of microfinance on the poor and poverty reduction suggests mixed results. It has been found that improvements in the access of the poor to credit in the form of microcredit have positive welfare effects through changes in consumption patterns, risk management, and increased economic self-sufficiency (World Bank, 2014). However, recent studies on the linkage between microcredit and poverty reduction and growth have shown the limitations of the effects of microcredit on entrepreneurship opportunities for the poor. In the past, it was argued that microcredit could not only reduce poverty but also incentivize entrepreneurship among the poor. Recent findings, however, show a rather unclear picture concerning such entrepreneurial effects, arguing that microfinance has only a relatively small effect on investment (See Giné and Morduch, 2010; Morduch and Karlan, 2009). Nevertheless, microcredits are an important source of financing for the poor, and although the effects of microfinance on investment are contested, most studies show microcredit does have a positive effect on the poor via increases in wages.

4 The Central Bank of Ecuador's mission and policy objectives

In the mid-nineties, the Ecuadorian economy deteriorated rapidly due to several factors. On one hand, three external shocks struck the economy: the Mexican crisis, the war with Peru, and the El Niño phenomenon, which caused vast crop losses and flooding. On the other, due to internal problems, political instability reached a new high, and massive protests ended in the ousting of President Abdalá Bucaram. As a result, between 1995 and 1999, the percentage of people living below the poverty line increased from 34% to 56%, and extreme poverty increased from 12% in 1995 to 21% in 1999 (Jácome, Estrella and Cordovez, 2004). Moreover, the rate of unemployment grew to 14.4%, GDP growth plummeted by 6.3% in real terms by 1999, and inflation spiralled from 22.8% in 1995 to 91% in the year 2000, when the dollarization scheme was adopted⁸ (see Figure 6). As a consequence of the crisis, migration increased substantially, primarily to the United States, Spain, Italy, but also to other European countries. In 1999, the National Government implemented drastic measures in an attempt to contain the crisis. One such measure was the freezing of all deposits and assets held in private banks in order to prevent runs on the banks and further capital flight. This policy was effective only up to a point, as it did not prevent the bankruptcy of some of the biggest banks. By the year 2000, the national currency, the sucre, had suffered a mayor devaluation of approximately 300%, which together with soaring inflation led the National Government to adopt the US dollar as the country's legal currency at a fixed exchange rate of 25,000 sucres.

Figure 6: Urban inflation and exchange rate evolution, 1995-2013



Source: Central Bank of Ecuador. Author's own preparation.

As a consequence of the crisis and the newly dollarized economy, the responsibilities of the Central Bank of Ecuador (BCE) as the country's monetary authority changed drastically; its power as lender of last resort and issuer of money was suspended and its mission, goals and responsibilities were redefined (see appendix). The BCE's new mission now centres on the proper functioning and regulation of the three sectors (private, public, and popular and solidarity-based) that form the financial system as outlined in the new Constitution. More specifically, the Constitution establishes that the country's economic policy goal is to maximize production and employment over time in order to guarantee economic stability⁹.

⁸ Central Bank of Ecuador, *Estadísticas Macroeconómicas: Presentación Estructural 2013*, <http://www.bce.fin.ec/index.php/publicaciones-de-banca-central3>

⁹ Constitution of the Republic of Ecuador (2008), Art. 283

The BCE's particular mission as defined by Ecuadorian law is, thus:

‘To promote and contribute to the economic stability and development of the country. To this end, it will have to follow the macroeconomic programme; contribute to the design of policies and strategies for the development of the country; and execute the monetary regime of the Republic, which includes the administration of the payment system, the investment of excess reserves, and to act as the public funds bank and as the fiscal and financial agent of the State.’¹⁰

To this end, the Executive branch designs the policies and the BCE is responsible for implementing and overseeing their execution. More specifically, the primary objectives of the BCE outlined by the law are to¹¹:

- Seek macroeconomic stability,
- Participate in the development of the country’s macroeconomic programme and to execute it,
- Define the country’s long-term growth objectives ,
- Manage the monetary reserves,
- Oversee the proper functioning of the payment system,
- Act as a financial agent for the State,
- Preserve the country’s cultural patrimony,
- Develop social welfare programmes

A new objective has been added to this list, namely the BCE’s responsibility to manage and oversee the financial inclusion programme developed by the National Government. The Constitution mandates the Government to promote access to financial services and credit especially for excluded groups and low-income households, and to increase productivity and competition in those productive sectors whose activities are aligned with the Government's National Development Plan (Arregui et al., 2012).

One of the mechanisms by which the Central Bank is attempting to promote more access to credit for the poor is through the promotion of the national payments system¹². The idea is to use the different modules of the national payments system to expand access to basic financial services, such as payments and remittances and more sophisticated services, such as credit and insurance, for the target population, e.g. by allowing payroll payments and payments to providers via internet transfer or by allowing recipients of remittances to access them via any ATM. These measures lower the costs for service providers as well as for users, and reduce the time needed to execute transactions.

It is worth noting that with the Constitutional amendments and the creation of the popular and solidarity-based sector, the Government also created several public institutions responsible for overseeing the proper functioning of this particular sector. One of these institutions is the National Corporation for Popular and Solidarity-based Finance (CONAFIPS), which was originally created and developed in 2007 as the National Microfinance Programme. This has been transformed over the past few years into an independently administered and funded public institution, CONAFIPS, responsible for supporting the popular and solidarity-based financial sector through policies that promote

¹⁰ Central Bank of Ecuador (2012a)

¹¹ Ibid.

¹² The national payments system is a technological and administrative platform that is used by the BCE to manage all financial and monetary operations, such as distribution of the budgetary funds allocated to each public institution; payment and processing of pay cheques, and wire transfers between institutions (Arregui et al., 2012).

financial inclusion. CONAFIPS works primarily as a second tier bank that provides funding to cooperatives and credit unions at much lower interest rates in order to create incentives for these organizations to supply credit to individuals and entrepreneurs in the popular and solidarity-based sector.

Through these mechanisms, the BCE, together with popular and solidarity-based public institutions such as CONAFIPS, has been seeking not only to provide access to financial services to the excluded population, but also to help boost the production of smaller sectors and create incentives for entrepreneurs to invest, in an attempt to strengthen the economy, foster growth and create more jobs.

In addition to this, after dollarization, under the terms of government monetary policy, the BCE's ability to use traditional channels to maintain price stability and to promote growth and economic stability was curtailed. After the BCE lost its role as lender of last resort, central government established a new law in 2008 in support of the financial safety net initiative aimed at providing stability and safety to the financial system. The financial safety net is built on four core pillars: (a) strengthening of the supervision and oversight of banks based on risks; (b) the creation of the liquidity fund¹³, which allows the BCE to act as lender of last resort; (c) a banking resolutions scheme, which allows troubled institutions to exit the market in a non-traumatic way; and (d) a deposits insurance scheme created to isolate insolvency claims and responsibilities from central government.

By the same token, central government has also introduced additional measures to control and protect the capital account. One such measure is the Capital Outflow Tax (Impuesto a la Salida de Divisas), introduced in 2008 in an attempt to control capital outflows more tightly and promote domestic investment. The tax was initially set at 0.5% in 2008, although it has been rising steadily and currently stands at 5%. This exit tax, collected by the Ecuadorian Internal Revenue Service, has to be paid by any and every individual or private company, national or foreign, that wants to take dollars abroad. Similarly, import tariffs have been introduced on over 500 products in an attempt to reduce investment in foreign goods and create incentives for domestic investment instead.

In terms of managing the monetary reserves, the BCE is responsible for designing policies targeted at guarding the country's international reserves and investing them appropriately, in order to guarantee the country's liquidity and financial solvency. These investments are placed for up to 180 days with an interest rate ranging from 0.01% to 0.5%. In 2013, the BCE's foreign investments abroad totalled 990 million dollars. The BCE also manages the domestic investment reserve mechanism¹⁴. Through this mechanism, it provides funding to public financial institutions to be invested in development projects, the aim being to strengthen development banking. By law, the BCE is not allowed to provide direct credit to financial institutions or users. For this reason, the reserve mechanism channels funds to public financial institutions, which are allowed to make direct contributions to development projects, or provide credit to financial institutions so that these can provide the credits. As of 2013, the BCE had allocated 2,679 million dollars to six public institutions (see Table 3). Lastly, the investments are registered at market value, and offset by counter credits to the asset account "reserves from non-operating results".

¹³ The liquidity fund is financed through contributions from all financial institutions and gains from their investments and operations, and managed by the BCE. The fund provides credit to troubled institutions to be repaid within 120 days (Central Bank of Ecuador, 2013b).

¹⁴ The reserve mechanism is administered by the ECB. The investments made are not subject to "collateralization", do not require provisions as established by the law, and are not subject to the limits mentioned in Art. 72 of the General Financial Institutions System Act

Table 3: Domestic investment reserve mechanism: Funds allocation, 2013

Public Bank/Institution	USD (thousands)
Banco del Pacifico	179,000
Banco del Estado	544,936
Banco Ecuatoriano de la Vivienda (Ecuadorian Housing Bank)	44,048
Banco Nacional de Fomento (National Development Bank)	406,083
National Financial Corporation	1,252,541
CONAFIPS	252,833
Total	2,679,441

Source: Central Bank of Ecuador, Notes to the Financial Statements, 2013

Moreover, the new Constitution also mandates the BCE to administer and promote rates of interest (lending and deposit) that will stimulate saving and financing of productive activities, aiming to keep prices stable and equilibrium in the balance of payments¹⁵. Setting (maximum) reference interest rates allows the Bank to exercise tighter control over the interest rate and helps prevent collusive practices by the biggest banks. It also aims at allowing different segments of the market to gain access to credit more easily. Since 2008, the reference interest rates set by the BCE have decreased and remained stable. In response, market interest rates have also been declining in recent years and remained fairly constant (see Table 4 below).

Table 4: Lending and reference interest rates by credit segment, 2008-2014

Average lending rates, %	2008	2009	2010	2011	2012	2013	2014
Productive: Corporate	10.09	9.25	8.98	8.43	7.87	8.37	7.98
Productive: SMEs	12.75	10.98	11.38	11.32	11.28	11.30	11.27
Productive: Businesses	-	-	9.82	9.57	9.56	9.59	9.46
Consumption	17.60	15.44	15.74	15.96	15.91	15.94	15.98
Home Loans	12.19	11.10	10.74	10.57	10.60	10.97	10.91
Retail Microcredit	35.12	30.60	30.81	28.99	28.84	28.72	28.36
Simple Accum. Microcredit	29.96	29.21	27.78	25.35	25.27	25.36	24.86
Extended Accum. Microcredit	21.22	22.41	22.73	22.75	22.65	22.14	21.96

Average reference (maximum) interest rates, %	2008	2009	2010	2011	2012	2013	2014
Productive: Corporate	10.90	9.33	9.33	9.33	9.33	9.33	9.33
Productive: SMEs	14.50	11.83	11.83	11.83	11.83	11.83	11.83
Productive: Businesses	-	-	10.21	10.21	10.21	10.21	10.21
Consumption	19.50	16.30	16.30	16.30	16.30	16.30	16.30
Home Loans	12.80	11.33	11.33	11.33	11.33	11.33	11.30
Retail Microcredit	37.50	33.90	33.90	30.50	30.50	30.50	30.50
Simple Accum. Microcredit	36.50	33.30	33.30	27.50	27.50	27.50	27.50
Extended Accum. Microcredit	25.50	25.50	25.73	25.50	25.50	25.50	25.50

Note: Interest rates correspond to the month of April. Source: Central Bank of Ecuador (2012 b), (2013a), (2014). Author's own preparation

¹⁵ Constitution of the Republic of Ecuador (2008), Art. 302

Since the changes in regulation were put into effect, interest rates for the different credit segments have been decreasing. For example, the manufacturing corporate rate decreased from 10.09% in 2008 to 7.98% in April of 2014. Similarly, the interest rate for small and medium enterprises (SME) has also decreased, although more slowly, falling from 12.75% in 2008 to 11.27% in 2014. The average interest rate for consumer spending has remained relatively constant in the last few years, and the average interest rate for home loans also decreased by about one percentage point between 2008 and 2014.

The largest decrease in interest rates can be observed in the microcredit segment, where there has been a 6.8 percentage point decrease over the six-year period. In this category, entrepreneurs and individuals who seek credit have seen an improvement in the conditions, although the rate is still much higher than that offered to SMEs, and more than three times higher than the corporate rate. Nevertheless, the volume of credit given to microcredit had increased from an average of 115.8 million dollars in 2008 to 197.1 million by the first quarter of 2014.

Setting differentiated interest rates for each segment of the credit market is an economic policy that aims at facilitating access to credit to the different sectors of the economy and contributes to the BCE's goal of keeping the financial system stable. In the case of Ecuador, even with the differentiated interest rates, it is still the largest firms which have better financing opportunities, while smaller entrepreneurs, who represent a higher risk to banks, still face constraints when accessing credit. In terms of credit volumes, the largest share, almost 60%, goes to private corporations, businesses and SMEs, while only around 11% goes to microcredit¹⁶ (see Table 5 below).

Table 5: Shares of credit volume by segment (as percentage), 2008-2014

	2008	2009	2010	2011	2012	2013	2014
Productive	60.0	62.6	59.4	58.2	58.7	62.0	59.9
Consumption	22.8	22.0	24.7	27.5	26.0	25.2	26.6
Home Loans	5.5	5.4	4.4	3.9	3.0	2.0	2.4
Microcredit	11.8	10.0	11.5	10.5	12.3	10.9	11.2

Source: Central Bank of Ecuador (2012 b), (2013a), (2014). Author's own preparation

The gap between credit segments, especially between manufacturing and microfinance, can be explained partly by the high costs and risks that loans to entrepreneurs represent to financial institutions, which usually prefer to provide financing to more solid and bigger firms that have a lower probability of default. Also, as indicated by the Head of Financial Inclusion in the BCE, there is currently no legislation that allows the Central Bank to set differentiated, or special, interest rates for the popular and solidarity-based sector, which places that sector at a disadvantage in comparison to other financial institutions¹⁷. This is what the BCE, together with other ministries and public institutions, is trying to phase out via policies that encourage inclusion. As discussed below, one of the products offered by CONAFIPS to participating cooperatives and credit unions is a much lower interest rate (4 to 5%), which has had a positive effect on the credit supply to members.

¹⁶ These numbers exclude the credit share of the Ecuadorian Social Security Bank (BIESS), which also offers lines of credit to its contributors. If the BIESS share is taken into account, the shares of the productive and microcredit segments are smaller, while the shares of consumer and home loans are slightly higher.

¹⁷ Under the current arrangements, popular and solidarity-based sector organizations follow the reference interest rates set for the microcredit segment for all financial institutions (private, public, and popular and solidarity-based sector).

5 Overview of financial inclusion policies

The new Constitution approved in 2008 states that one of the objectives of the Central Bank of Ecuador (BCE) is to implement the monetary policies determined by the Executive branch. Furthermore, the new Constitution defines the financial system as made up of the private and public sectors, and adds a third sector consisting of institutions in the popular and solidarity-based economy (cooperatives, credit unions, community banks and savings banks). Policies developed to strengthen the financial system are focused on the dynamism of these three sectors so as to maximize the growth potential of the poor and rural economies, raise income levels, reduce market failures, and reactivate or boost small economies (Arregui et al., 2012).

As discussed above, one of the BCE's policy objectives is to develop an integrated payment system that will allow the economy to work more efficiently, as well as channel capital into productive investment and thereby guarantee the country's development. The current administration has devoted resources to strengthening the national payments system by redesigning its platform to allow regulated and unregulated cooperatives and credit unions to join it and effect transactions through its integrated system. According to the official in charge of the implementation of the new financial inclusion policies, the modernization of the National Payments System is a crucial step in the progress of the financial inclusion programme.

As a consequence of the development and implementation of the Alternative Remittance Distribution Channel, co-funded by the Inter-American Development Bank (IDB) in 2010, the Central Government expanded the general vision of financial and social inclusion, and developed a more comprehensive financial inclusion programme to be implemented and administered by the BCE. The general goal of the programme is to extend access to financial services to the poor and those excluded from the formal financial system, as well as to entrepreneurs, and micro, small, and medium-sized enterprises (MSME), which are often constrained when it comes to access to credit.

Besides providing users with greater access to financial services, the goal behind Ecuador's financial inclusion policies is to develop the financial sector in a way that it encourages the population to save, build up assets and invest their saved income in productive activities safely and at low cost. The programme is also centred on extending lines of credit to MSME to create incentives for investment and growth in the smaller businesses and sectors of the economy, and thus contribute to GDP growth and employment creation.

The BCE's core financial inclusion policy has been developed at three distinct levels: macro, meso and micro in order to implement a comprehensive programme with a clear strategy that aims at maximizing positive outcomes. For each of these levels, concrete objectives have been set to implement the policies effectively, as discussed below.

5.1 Macro level

At the macro level, the aim of financial inclusion policy is to promote a legislative framework of rules and regulations allowing oversight of the proper functioning of the financial system as a whole. As mentioned in Arregui et al. (2012), at this level, the Central Bank focuses on the supervision and regulation of processes, creates new methodologies for the legalization of contracts and property titles, devises the rules and standards for non-

banking correspondents¹⁸, and provides mobile banking services, for example. At this stage, there have been several proposals to strengthen the regulatory framework of financial inclusion policies, as well as to strengthen the legal structure of the national payments system and mobile payment system. In the case of the financial inclusion framework, the rules aim to simplify microcredit operations, to provide support to network administrators in charge of inter-bank transactions and information sharing, to provide guidelines to incorporate the non-banking correspondents to the national network and mobile payment system, and to simplify the rules and requirements imposed on private and public institutions to access the national payments system¹⁹. In terms of strengthening the national payments system legal framework, the regulations seek to give the BCE the power to impose mandatory rules to be followed by those in charge of administering payment systems, to require BCE clearance in any payment systems implemented in the country in the future, to sanction those institutions that violate any terms of the payment systems regulations, and to control remittance payment agents, electronic transfers and data transmission from one bank to another.²⁰

5.2 Meso level

At the meso level, the focus is on devising reforms to strengthen the financial system through inclusive payment systems and consumer protection. The aim is to have a more transparent flow of information in an integrated system to build the trust of potential users and the previously excluded portion of the population. Also, the idea is to create synergies between the public, private, and popular and solidarity-based sectors in order to foster good financial practices and the financial education of individuals, and to regulate and strengthen credit bureaus and risk management offices by sharing information (Arregui et al., 2012, p. 23). To achieve these goals, the BCE has devised a strategy to strengthen the national payments system by investing in new hardware and redesigning its software in order to modernize the system and move towards the use of electronic payments and transactions. Additionally, a more modern infrastructure allows the national payments system to expand its coverage safely and offer higher quality products to users. Lastly, the ECB has also invested in training and education of institutions in the use of the national payments system, and plans to implement a financial education programme for potential users to teach them about the importance of making good financial decisions, and to create new incentives for further interactions with the formal financial system.²¹

5.3 Micro level

Lastly, at the micro level, the BCE's aim is to offer support to the institutions involved in the programme by offering technical cooperation and support in the creation of financial products, particularly in terms of the requirements and processes to open a bank account, and guidelines to avoid over-indebtedness of customers. It also offers technical support in adapting to the use of new technologies, it provides support in the expansion of banking branches and points of sale (POS) in rural areas and the city suburbs (Arregui et al., 2012). At this level, the Bank has created and currently regulates two interrelated payment systems: (1) a networking system (Red de Redes) that links all public, private and popular

¹⁸ Non-banking correspondents are third parties and external channels that financial institutions such as banks can use (under their own responsibility) to offer financial services to users, as long as the third party meets the requirements and has been cleared for operation. In this way, they offer deposit and withdrawal of money services, transfers between accounts, payment services for utilities, and payment of the human development bond (Junta Bancaria (Banking Board), Resolution JB-2008-1150, Art 8).

¹⁹ Arregui et al. (2012)

²⁰ Ibid.

²¹ Ibid.

and solidarity-based institutions into one integrated system in order to reduce transaction costs and improve their efficiency. Through this networking system, the BCE is planning to offer ten different products, of which three are already being offered to the institutions belonging to the national payments system. These products are: a “shared counter”, which allows users from participating financial institutions to make transactions (deposits and withdrawals) in a bank/credit union other than the one where they have their account/or to which they belong; transfers through the Inter-banking payments system, and the payment of the human development bond via account crediting; (2) electronic money which takes advantage of rising mobile phone use in the country. This system will allow users to exchange physical dollars for “virtual money” on their mobile phones, and use it to pay for goods and services, make transfers, pay taxes, collect the human development bond, etc., under a 1:1 conversion rate²². The motivation is that the use of electronic money is safer and it does not require a user to have a bank account in order to use it²³, which makes it easier for the excluded population to participate. Additionally, the BCE's hope is that the use of mobile technology will indirectly widen the reach of financial services to rural areas without the need for physical bank branches, as individuals start transacting with electronic money. As explained by the Bank's electronic money project manager, the primary uses of electronic money are:

- Loading money on to cell phones and/or cashing electronic money into hard currency
- Electronic money transfers between users
- Electronic money transfers between retail stores and users (to buy goods and services)
- Electronic money transfers between government and users (payment of cash transfers, tax payments, etc.)
- Payment of utilities and services

This will allow users to make such transactions faster and, in terms of transaction costs, will represent a cheaper alternative. Although a thorough study has not yet been made, the BCE's electronic money project manager estimates that there will be 500,000 to one million users in the first year, which will grow to about four million users by 2020. Similarly, the Bank estimates that the daily amount of money in circulation will reach 140 to 160 million dollars by 2020, or about 20% of the country's circulating capital²⁴.

In addition to this, the BCE has decided to incorporate all regulated and unregulated cooperatives and credit unions in its national payments system in order to raise the number of payment points, especially in rural areas, and to increase the access of the rural population to formal financial services. To this end, the Bank has launched a campaign to reach out to the more than 900 credit unions that currently operate in the country. Each credit union has to go through a qualifying process in order to be approved by the BCE before it can start providing services through the National Payments System. This process gives the BCE better control and oversight of transaction flows and more accurate data reports on the amount of money transacted daily. Furthermore, it has allowed the Bank to reach 75% of all communities through the more than 323 credit unions that currently subscribe to the programme, either directly or indirectly through another acting as a central hub.

²² At the time of writing it is unclear whether the conversion rate will be regulated or set in the law that governs electronic money

²³ The only requirement is to be an Ecuadorian citizen, have a valid ID, and be of legal age (18)

²⁴ Valencia (2014) and personal interview with BCE's Head of Electronic Money.

5.4 Human development bond and remittances

As mentioned above, the financial inclusion policies developed by the Government and implemented by the Central Bank of Ecuador (BCE) were intended as an extension of two pilot programmes. One was a plan to facilitate and expand the coverage of remittance payments through the inclusion of regulated and unregulated cooperatives and credit unions in the inter-bank payments system. The second was launched to expand the human development bond payment points through the use of cooperatives, credit unions and popular financing entities.

The remittances programme was developed in the year 2008 and implemented over the next four years. The main objective was to make regulated and unregulated cooperatives and credit unions part of the national payments system, in an attempt to provide them with the necessary infrastructure to make payments directly and without the need for expensive intermediaries. The programme was co-financed by the Inter-American Development Bank and the BCE for a total amount of USD 1,103,500. In addition, the Bank also launched a massive campaign explaining the benefits of joining the national payments system as well as its uses and requirements, targeting more than 600 financial institutions all over the country. By 2012, more than 180 cooperatives and credit unions had joined the payment system (either directly or through a central hub), and had processed and circulated approximately 2,500 million dollars.²⁵ This translates into a 20% increase in new remittance recipients through participating cooperatives and credit unions.

A similar proposal to use the same payment system to deliver the Human Development Bond to its recipients was put forward. In this way, it allowed beneficiaries to receive the cash transfer either via direct deposit to their savings accounts (at their local credit union), or they could withdraw it at any of the banks that are part of the BANRED ATM network system. By 2012, as a consequence of this programme, the ECB had over 1,000 payment points for the bond nationwide thanks to participating cooperatives and credit unions, increasing coverage to 75% of the country (Arregui et al., 2012). This has undoubtedly played a complementary role in the expansion of the Financial Inclusion Policy, and has helped the ECB to reach that segment of the population that had previously had only limited access to the formal financial system. By July 2014, 1.7 million people were receiving the human development bond; of those, about 45,000 were paid by direct deposit. In addition, 26,000 children under one year and 28,000 mothers received the Zero Malnutrition Bond (an additional government cash transfer programme targeting malnutrition) via direct deposit through credit unions affiliated to the national payments system (Arregui et al., 2012, p. 82).

5.5 The role of CONAFIPS

The ECB is not the only institution that has developed more financially inclusive policies. After the creation of the popular and solidarity-based sector in the Constitution, several other public institutions were created to tackle the different issues and deficiencies of the popular and solidarity-based sector. Due to space constraints, we focus on one of these institutions, whose two main areas of interest are financial and social inclusion. This institution is the National Corporation for Popular and Solidarity-based Finances, CONAFIPS, which has been developing an integral programme for the development and inclusion of poverty-stricken areas where financial institutions are generally absent. Through the Act on the Popular and Solidarity-based Economy and the Popular and Solidarity-based Sector (LOEPS) passed in 2011, CONAFIPS was officially constituted²⁶

²⁵ Arregui et al., 2012, p. 82

²⁶ Although it had been operating as a programme since 2007

as a kind of “people's bank”, a financial institution serving the popular and solidarity-based sector and helping it to develop. CONAFIPS' main roles are:

1. Analysis of popular and solidarity-based financial sector organizations and integral evaluation of their performance.
2. Strengthening of popular and solidarity-based financial sector organizations by providing training, technical assistance and transfer of technology.
3. Financial products: Providing financing and credit lines focusing on the sector's needs.
4. Financial services: Providing guarantees for the popular and solidarity-based economy and administering third party resources²⁷.

As explained by CONAFIPS' Capacity-Building Coordinator, an integral component of the institution's responsibilities is the evaluation and qualification of popular and solidarity-based organizations. The evaluation consists of two parts, a quantitative part and a qualitative part. The quantitative part focuses on evaluating organizations' financial performance and the degree to which their programme is inclusive. The qualitative evaluation aims at raising the bar in terms of good management and accounting practices, as well as having a good record as social agents. In this way, CONAFIPS evaluates not only the organization's financial position, but also considers social and administrative factors that contribute to inclusiveness, especially with the smaller organizations that tend to have weaker finances.

Once the organizations have been evaluated, CONAFIPS' next objective is to strengthen those which are weak in terms of any of the evaluation criteria. To this end, the CONAFIPS provides training to managers, employees and partners, technical assistance in business management and administration, and legal assistance, as well as transfers of technological tools and the information system software needed to operate. The objective of building and strengthening the capacity of these organizations is to have higher quality management practices and increase productive investment in the popular and solidarity-based economy, especially in the regions. Ultimately the goal is to consolidate the popular and solidarity-based financial network and increase social inclusion.

As a second-tier financial institution, CONAFIPS offers several products to popular and solidarity-based organizations such as credit lines; credit to strengthen their capacity to finance productive investment; credit to co-finance inclusion programmes with other development agencies or institutions; the human development credit; credit for popular housing projects; credits for projects related to sustainable land use; and credit for young entrepreneurs²⁸. As will be seen below, these lines of credit have allowed CONAFIPS to reach various sectors of the economy, especially in poorer areas.

Finally, CONAFIPS has created two further mechanisms to develop the popular and solidarity-based economy and oversee popular and solidarity-based organizations. One is the Guarantee Fund for the Popular and Solidarity-based Economy, through which CONAFIPS provides guarantees for those borrowers who do not have any collateral, particularly for popular housing loans and microfinance initiatives. Secondly, CONAFIPS manages resources from other public or private institutions, national or foreign, which support the development of the popular and solidarity-based economy, channelled through popular and solidarity-based organizations²⁹.

²⁷ CONAFIPS (2013)

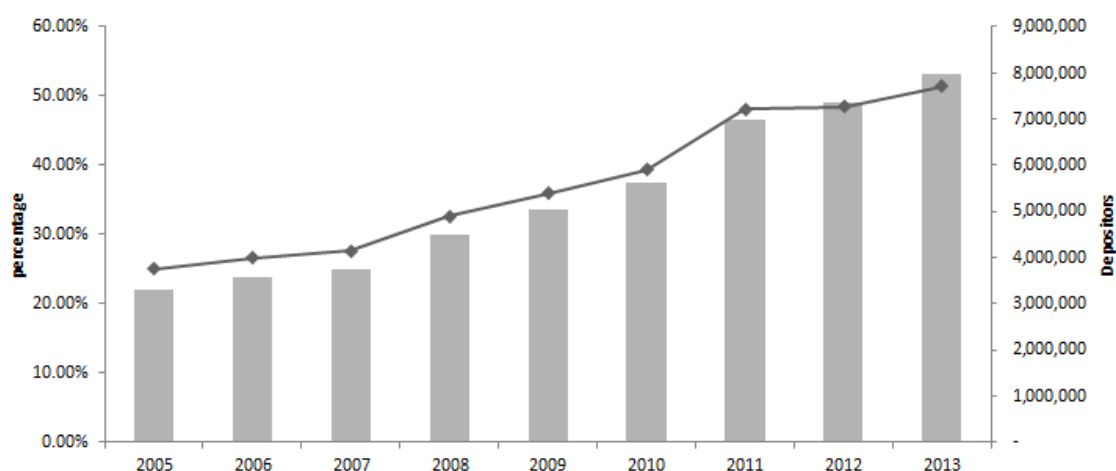
²⁸ CONAFIPS (2013).

²⁹ Ibid.

6 Measuring access to financial services in Ecuador

In terms of access to financial services, several indicators show Ecuador's progress towards a more financially inclusive economy. Firstly, in terms of the share of adults that have a bank account, measured as the ratio of depositors to the total population, there has been a major advance in the private banking sector, which more than doubled from 25% in December of 2005 to 51.4% by the end of 2013. In terms of year-on-year variation, 2011 experienced a 9% increase compared to the previous year. More recent data shows no change from 2011 to 2012, and a 3% increase in the share of adults with a bank account by 2013. This indicates that there has been a surge in the number of individuals who have gained access to financial services, especially after 2008 and a steady growth in deposits even through the financial crisis in 2009 (see Figure 7).

Figure 7: Share of credit volume



Source: Superintendency of Banks and Insurance (SBS), Financial Newsletter on Private Banks, 2002-2014

Similarly, when looking at the trends in financial inclusion in the popular and solidarity-based sector, the use of financial services has also been growing steadily. For example, the share of adults with an account in a cooperative or credit union increased from 10.7% in 2005 to 22.4% in 2011³⁰, and deposits grew by 300% in the six-year period. The account penetration of mutualistas, smaller financial institutions that provide loans to users, rose from 1.9% in 2005 to 2.4% in 2013, and in financial societies, the share grew from 0.08% in 2005 to 0.15% in 2013 (see Table 6). The increase in account penetration, especially after 2008, is an indication that the changes in the regulation have had a positive impact on financial inclusion. Looking at the public banking system, there has also been an increase in account penetration, from 1.3% in 2005 to 10.3% in 2013. This dramatic leap was the result of new regulations introduced in 2008, aimed at strengthening the public financial sector in order to build a solid subsector to promote social and productive investment, especially in smaller sectors of the economy³¹.

In terms of provider-side indicators, such as bank branch density, the number of main branches per 100,000 inhabitants has in fact decreased slightly from 0.19 branches per 100,000 inhabitants in 2005 to 0.16 in 2013³², possibly due to the absorption or liquidation of some banks. In contrast, for cooperatives and credit unions, branch density increased from 0.24 branches per 100,000 people in 2005 to 0.27 in 2011. It is worth noting that

³⁰ Data available only until 2011

³¹ SENPLADES (2013), Objective 11

³² The density is reported for main branches or headquarters only. The National Studies Bureau/Statistical Office (Dirección Nacional de Estudios/Subdirección de Estadísticas)

branch density could be lower in future years as the Central Bank extends control and qualification of credit unions and their inclusion in the national payments system. Organizations from the popular and solidarity-based sector could be liquidated or absorbed if they fail to meet the requirements.

Total savings are an important indicator not only of formal financial activity but also of the degree of confidence of individuals in the financial system. Figure 8 shows the evolution of total deposits by type of financial institution. Credit unions and public institutions experienced the fastest expansion in deposits, with 392% and 1,305% respectively in 2002-2011 and 2002-2013. This expansion represents an easing of the conditions under which users can open an account, in particular for credit unions. Smaller institutions in the popular and solidarity-based sector have also experienced steady, if slower, growth. Private Banks have also seen an encouraging expansion of 260% in the last 11 years, suggesting that more people have trust in banks and are able to open an account. It is important to note that deposits alone do not give a complete picture of how financially inclusive the Ecuadorian financial system is. Information on new deposits gives a better idea of the extent to which financial services are reaching new users. Nevertheless, it can give a general idea of the increased confidence of users in financial institutions and the simplification of requirements for becoming part of the formal financial system.

Table 6: Account penetration (as a percentage), 2005-2013

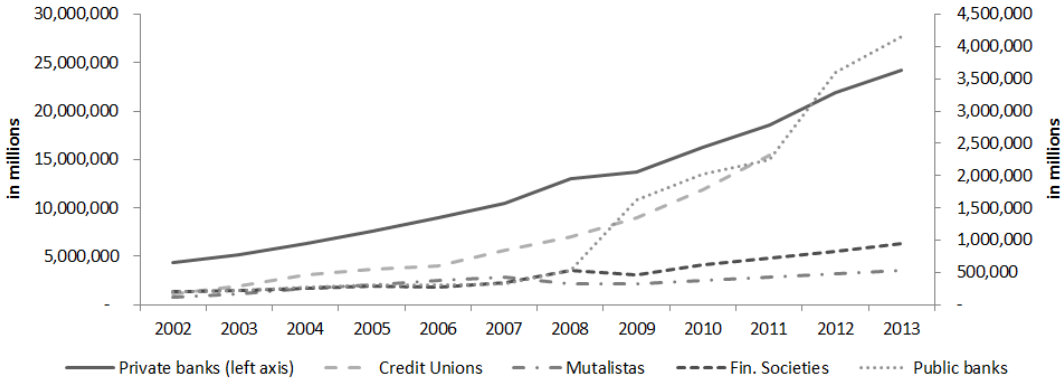
Year	Private Banks	Credit Unions*	Mutualistas	Financial Societies	Public Banks
2005	24.98	10.71	1.87	0.08	1.34
2006	26.57	14.09	2.30	0.10	1.36
2007	27.61	16.85	2.64	0.11	2.44
2008	32.58	18.59	2.07	0.09	3.78
2009	35.94	20.45	2.17	0.13	6.65
2010	39.35	23.22	2.18	0.15	8.07
2011	48.13	22.43	2.28	0.20	9.05
2012	48.40	-	2.33	0.20	9.95
2013	51.40	-	2.44	0.15	10.32

*No data available beyond 2010

Source: SBS, National Directorate of Studies/Department of Statistics. Author's own preparation.

In order to have a clearer picture of how credit is distributed among the different actors, we look at the evolution of gross loans in the financial system, with a special focus on microcredit. In 2012, gross loans totalled USD 23.8 million, an increase of 14.6% in relation to 2011, which closed the year at USD 20.8 million.

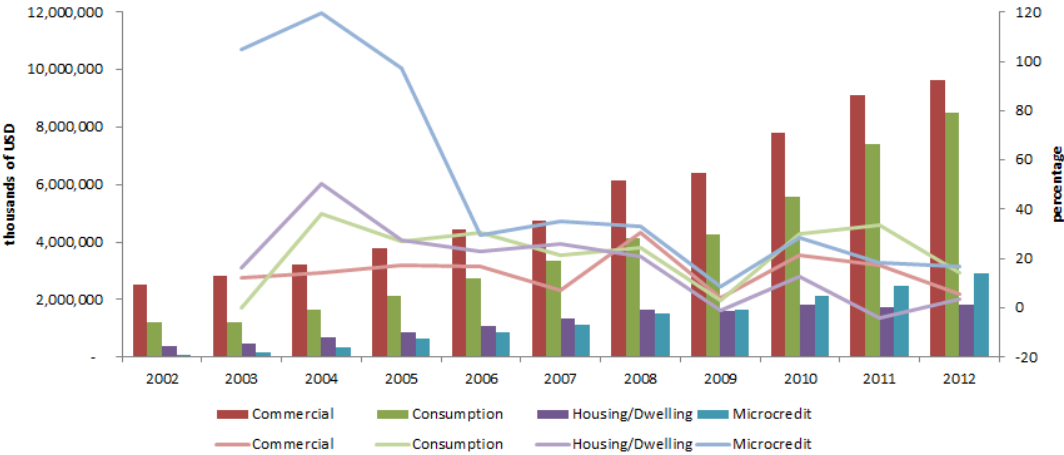
Figure 8: Evolution of total deposits



Source: Superintendency of Banks and Insurance (SBS), Financial Newsletters on different financial institutions, 2002-2014

For the microcredit segment, loans totalled USD 2.9 million in 2012, an increase of USD 416,717 in comparison to the previous year. Of the total allocated to microcredit in 2012, 85% was the result of the combined input by private banks (USD 1.29 million.) and cooperatives and credit unions (USD 1.18 million.). Yet in terms of credit growth, as the economy slowed in 2012, loans for all credit segments taken together contracted. Within this, microcredit grew at a slower rate in 2012 (16.1%) compared to the 18.1% observed in 2011, while the consumer segment experienced the largest fall-off in growth, 19 percentage points, from 33.6% in 2011 to 14.5% a year later. Housing was the only segment that experienced an improvement in credit allocation, reporting growth of 3.3% in 2012 (see Figure 9).

Figure 9: Evolution of credit by segment, 2002-2012



Source: SBS, National Directorate of Studies, Financial Newsletters on different financial institutions, 2002-2014

Between 2011 and 2012, credit growth in the microcredit segment came from banks (6.1%), cooperatives and credit unions (20.2%), public banks (58.5%) and mutualistas, the latter being the most dynamic of all the financial institutions, growing by 125.1% (see Table 7). The contribution of financial companies to the microcredit segment declined between 2011-2012 by 15.7 per cent. In terms of market share for microcredit, private banks and cooperatives and credit unions cover about 85% of the market, while the share of public banks, at 13.37%, has been increasing in recent years.

Table 7: Evolution of microcredit loans (in thousands of dollars), 2002-2012

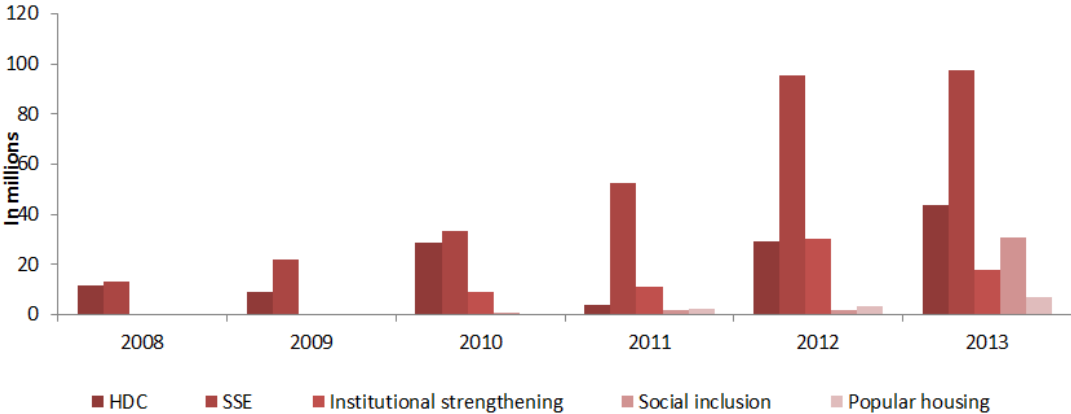
Year	Banks	CCUs	Mutualistas	Financial Societies	Public Banks	Total
2002	56,673	5,533	1,136	7,071	2,831	73,244
2003	99,197	50,177	864	-	-	150,238
2004	201,981	114,044	577	13,255	-	329,858
2005	345,862	284,008	357	20,904	1	651,131
2006	483,466	354,133	265	3,046	1,665	842,575
2007	635,591	443,298	166	33,066	28,368	1,140,489
2008	834,216	557,963	585	21,292	103,19	1,517,245
2009	869,977	601,544	1,357	33,161	139,703	1,645,740
2010	998,184	721,529	1,74	38,594	350,484	2,110,531
2011	1,219,403	986,635	4,507	37,068	245,418	2,493,031
2012	1,293,287	1,186,097	10,147	31,251	388,965	2,909,748
Change 2011-2012	6.1	20.2	125.1	-15.7	58.5	16.7
Credit Share(2012)	44.45	40.76	0.35	1.07	13.37	100.00

Source: SBS - National Department of Studies, various Financial Newsletters. Author's own preparation

There have also been interesting developments in access to financial services and credit by popular and solidarity-based sector organizations, and their members. In the last five years, CONAFIPS has expanded the allocation of credit to several lines or segments: the human development credit, the social and solidarity-based economy, institutional capacity building, social inclusion and popular housing. Of these five segments, the social and solidarity-based economy and the human development credits have experienced the highest surge in demand in the period 2008-2013, with 56.5% and 22.7% respectively, (see Figure 10). The social and solidarity-based economy credits are used for the development and financing of productive entrepreneurship and to support projects developed by the different community based organizations. Similarly, the human development credit allows beneficiaries of the human development bond to obtain a loan in the form of an human development bond advance of up to USD 420, to be repaid within a year at a 5% interest rate. This credit can be used for micro-finance investments in production, commerce or services and has the advantage of offering a much lower interest rate to low-income families. Between 2007 and 2012, 982,041 people obtained the human development credit, representing an investment of USD 561 million. In 2012, the human development credit was requested by 87% of beneficiaries of the human development bond, of which 65% was invested in productive ventures and 30% in agricultural production.³³

³³ *Bono abre la puerta hacia el pago de deuda histórica* (Bond opens the door to the payment of historical debt) (2012). Data for 2012 is from January to October.

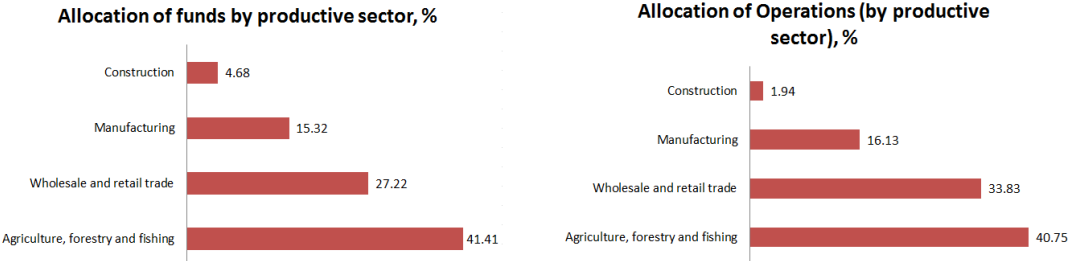
Figure 10: CONAFIPS' Allocation of credit by segment, 2002-2012



Source: CONAFIPS, Management Report 2008-2013. Author's own preparation.

In terms of productive sectors, the total allocation of funding provided by CONAFIPS is distributed across several sectors. The main ones are shown in the left-hand panel in Figure 11: agriculture, hunting, and forestry received 41.4% of total funding; wholesale and retail trade captured 27.2%; manufacturing 15.3%; and construction a smaller portion, 4.7%, of the total funding of 554.09 million dollars for the period 2008-2013. The right-hand panel shows the distribution of operations and resources in the different productive sectors: 40.8% in agriculture, hunting, and forestry received, followed closely by wholesale and retail trade with 33.8% out of a total of 543,908 operations. Manufacturing industry and construction accounted for 16.1% and 1.9% of operations, respectively.

Figure 11: Credit allocation and operations by productive sector, 2002-2012



Source: CONAFIPS, Management Report 2008-2013. Author's own preparation.

As of 2008, the Ministry of Economic and Social Inclusion had registered 1,219 cooperatives and credit unions (CCU), mainly concentrated in the capitals of the provinces and main cantons³⁴, whereas 88 cantons or 40% do not have a CCU in their territory. In 22% or 47 cantons, there is only one CCU, and in 10% or 22 cantons there are two CCUs operating³⁵. Although the allocation of funds depends on the number of CCUs present in the province, CONAFIPS has sought to allocate funds to those regions that need it the most (see Table 8).

³⁴ Ecuador is divided into 24 provinces, cantons, and municipalities. Provinces are formed of several cantons. A canton is an administrative unit or subdivision established for political or administrative purposes
³⁵ MIES (2008)

Table 8: Funding allocation by province, 2008-2013

Province	Amount (USD millions)	%	Operations	%
Tungurahua	65,160,675.08	11.67	54,424	10.01
Azuay	54,177,583.72	9.78	21,259	3.91
Pichincha	54,142,096.68	9.77	35,511	6.53
Cotopaxi	47,620,676.59	8.59	39,234	7.21
Manabí	44,175,693.51	7.97	73,613	13.53
Chimborazo	37,137,438.92	6.70	28,974	5.33
Guayas	36,389,865.56	6.57	76,126	14.00
Imbabura	35,928,004.80	6.48	32,833	6.04
Bolivar	28,205,969.61	5.09	27,813	5.11
Los Ríos	26,849,499.97	4.85	36,669	6.74
Carchi	20,681,643.96	3.73	15,277	2.81
Sto. Domingo	19,816,734.16	3.58	20,719	3.81
Loja	15,388,457.14	2.78	12,144	2.23
Zamora Chinchipe	13,486,274.39	2.43	5,242	0.96
El Oro	13,096,947.09	2.36	15,681	2.88
Esmeraldas	7,315,470.26	1.32	11,533	2.12
Napo	7,144,280.66	1.29	6,768	1.24
Pastaza	6,054,131.56	1.09	6,16	1.13
Cañar	6,001,128.07	1.08	5,88	1.08
Morona Santiago	4,900,211.36	0.88	3,306	0.61
Santa Elena	3,963,237.83	0.72	4,956	0.91
Sucumbíos	3,712,346.32	0.67	5,704	1.05
Fco. de Orellana	2,005,854.49	0.36	3,835	0.71
Galápagos	614,817.55	0.11	257	0.05
Undefined zone	123	0.02	20	0.00

Source: CONAFIPS, Management Report 2008-2013. Author's own preparation

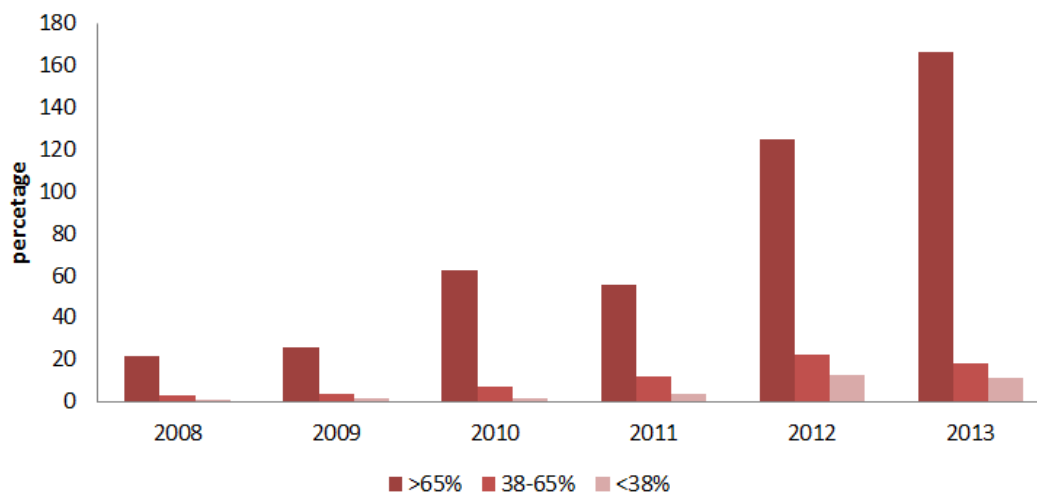
As discussed above, one of CONAFIPS' main objectives is to give credit and financing to the sectors and areas that need it most. To this end, CONAFIPS has concentrated its efforts on areas where the poverty rate is above 65% and has allocated 82.6% of its portfolio to these poverty stricken areas. To a lesser extent, there is also funding for areas where the poverty rate is between 38% and 65%, representing 11.8% of the portfolio, and 5.6% has been allocated to areas where the poverty rate is below 38% (see Table 9 and Figure 12).

Table 9: Portfolio allocation by poverty rates, 2008-2013

Year	Description	>65%	38-65%	<38%	Total
2008	USD millions	21.65	2.8	0.26	24.72
	Operations	70,675	988	187	71,85
2009	USD millions	25.85	3.38	1.62	30.85
	Operations	59,305	1,746	609	61,66
2010	USD millions	62.64	7.24	1.57	71.45
	Operations	72,404	5,244	1,173	78,821
2011	USD millions	55.71	11.84	3.86	71.41
	Operations	44,026	3,923	1,397	49,346
2012	USD millions	124.87	22.08	12.37	159.32
	Operations	130,697	10,103	4017	144,817
2013	USD millions	166.78	18.13	11.42	196.33
	Operations	122,875	8,883	5,686	137,444

Source: CONAFIPS, Resultados de la Gestión 2008-2013. Author's own preparation

Figure 12: Credit allocation by poverty rates, 2002-2012



Source: CONAFIPS, Management Report 2008-2013. Author's own preparation.

7 Current developments in monetary policy and outlook

Measurement of the degree of financial inclusion in the Ecuadorian economy is not an easy task because of several political and financial issues currently being debated. Firstly, the Executive Office has proposed a new Monetary and Financial Code to replace the one that has been in place since dollarization. The new Code has two main objectives, as indicated by the President: (1) to substitute 21 provisions of the current Code that underpinned the neoliberal model that caused the crisis in 1999, and (2) to reorganize the local financial system and to have greater control over the institutions that provide credit.³⁶ At the time of writing, the proposal currently being debated in the General Assembly has not yet been published, although some of the details have been shared with the public. The proposed Code has 516 Articles, 13 general provisions, 37 reformatory provisions, 35 transitional provisions, and 3 final provisions set out in three volumes: financial and monetary system; market regulation; insurance regulation³⁷. The new Code will have an impact on all current financial public institutions, which will be reorganized or dissolved. As for private financial institutions, if approved, the Code will require them to repatriate funds held abroad, disinvest and eliminate their foreign assets and portfolios. The new Code has created concerns in the banking sector, as it is not clear how it will affect short-term deposits and the population in general. It is also unclear how it will affect the financial inclusion initiatives put in place and the popular and solidarity-based organizations.

Additionally, there are growing concerns about the health of the government finances. The recent use of the country's physical gold reserves to buy gold have raised speculation that the Government is facing liquidity problems, as the ECB sold 644,000 ounces of gold to Goldman Sachs in exchange for 580 million dollars. This, together with the proposed new monetary code has raised concerns among analysts and investors who worry about the path the Ecuadorian economy might be taking.

Finally, there has been another proposal for a Constitutional amendment to allow all current publicly elected officers (president, mayors, general assembly members, representatives and councillors) to seek re-election indefinitely. Given that the government party holds the majority in the General Assembly, there are concerns that if approved, the amendment could lead the country to a more unstable political scenario and could even lead to abuse of power by some authorities.

³⁶ President *Rafael* Correa, Weekly televised presidential report.

³⁷ *Código Monetario y Financiero llega a la Asamblea y plantea el cierre del BEV* (Monetary and Financial Code reaches the Assembly and envisages the closure of the Ecuadorian Housing Bank) (2014).

8 Evaluation of progress and outlook for the financial inclusion programme in Ecuador

The impact of financial inclusion policies in an economy's development depends on their design and scope, the target population's response and good monitoring of the financial services provided. Nevertheless, policies that target inclusion have generally been associated with poverty reduction and a decrease in financial inequality. The section goes on to evaluate the progress of financial inclusion policies in the Ecuadorian economy and labour market and make recommendations for further development and support of the financial sector.

8.1 Savings

In general terms, the empirical evidence in support of greater access to basic payments and savings among poor households is positive. It also shows a strong correlation between financial inequality and income inequality; richer countries, where income is more evenly distributed, have a lower degree of financial inequality than lower-income countries where the rich are more likely to have a bank account than the poor (World Bank, 2014). Moreover, randomized controlled experiments have found evidence that greater access to savings accounts or simple savings technologies increases savings (See Aportella, 1999; Ashraf and Yin. 2006).

According to the available financial data, as discussed above, there has been an increase in total deposits in all institutions, especially private banks and cooperatives and credit unions. Similarly, there has been an increase in the proportion of adults that have a bank account, which is an indicator of improved access to financial services and credit. Focusing on the microcredit segment, the results are encouraging; in 2012 the total credit portfolio allocated to microcredit amounted to 2.9 million dollars, a 16.7% increase over the previous year or 416,000 dollars, allocated to productive investment in manufacturing, agriculture and services.

8.2 Access to credit and mobile banking

Improved access to credit can have positive effects on poverty reduction and entrepreneurial activity. Evidence suggests that limited access to credit is a deterrent to growth for small businesses and start-ups and an obstacle to entrepreneurship, thus suggesting that access to finance has positive effects not only for entrepreneurs themselves but for the economy as a whole.

In this respect, the modernization and re-engineering of the national payments system seeks to improve access to credit by incorporating as many organizations as possible from the popular and solidarity-based financial system in the platform. Although the financial inclusion policies were developed in 2010 and the regulations approved in 2012, there have been mayor delays in the progress of the programme, primarily due to changes in the board and administrative appointments at the Central Bank. These administrative changes stalled the financial inclusion programme for over a year and a half. As of now, of the ten products that the Bank has designed and wants to offer through the national payments system, only three have been fully developed and are currently available:

1. Shared counter service, which allows users from participating financial institutions to make transactions (deposits and withdrawals) in a bank/credit union other than the one where they opened their account/are members of,

2. Inter-bank payments system, which allows users to make wire transfers to other accounts,
3. Payment of the human development bond via account crediting

However, in order to offer such products, private banks and popular and solidarity-based sector organizations have to switch to the new technological network (*Red de Redes*) designed by the Central Bank, which has the capacity to offer such services. Out of the 323 that already are in the national payments system, only two credit unions have already implemented the new system and are operating. None of the private banks have completed the changeover to the new system, thus holding up progress in the Bank's financial inclusion initiatives.

In terms of the Central Bank's second instrument to promote inclusion, the electronic money project, progress is positive in terms of its technical development and the Bank's officials are currently implementing the software in the ECB's core system. At the time of writing, however, the regulations that will govern the electronic money platform are currently being drafted so the project has not been launched to the public yet. The timeline for the project launch, according to the electronic money project manager is as follows:

- August-September 2014: Training workshops for the actors involved,
- September-October 2014: Massive advertising campaign,
- November 2014: Launch of the electronic money project

Lastly, CONAFIPS is the institution that has made the most progress in the six years that it has been operating. It has successfully allocated 554.1 million dollars in the period 2008-2013, contributing to the growth of the popular and solidarity-based sector. Total deposits in cooperatives and credit unions grew by 174% between 2007 and 2011, and the popular and solidarity-based sector organizations made 47 million dollars in profits in 2011, or a 26.6% rise in comparison to 2010.³⁸

8.3 Social inclusion

One final aspect of financial inclusion policy is the fact that it enhances social inclusion. In terms of the popular and solidarity-based economy, social inclusion has been a key objective of the Government's National Development Plan. The inclusive policies pursued by the Government since 2007 have had a positive effect on alleviating poverty and reducing unemployment. For example, the human development bond and other cash transfers have successfully reached 1.7 million people, of whom 87% requested the human development credit to be invested in productive ventures (65%) and agricultural production (30%). This and other inclusive policies have resulted in a reduction in rural and urban poverty. The national poverty rate decreased from 36.7% in 2007 to 25.6% in 2013, one of the biggest reductions in Latin America.

Lastly, by attracting more people into the financial system, individuals will not only have more access to financing and other services but will also feel part of the system. It could act as an incentive for some to re-enter the labour market, or go back to school. There is some evidence of this in the increase in the employment rate and the decrease in the child labour rate.

³⁸ More recent data has not yet been released.

8.4 Conclusion

The scope of the Government's financial inclusion programme is wide and varied. This paper has attempted to encapsulate the main objectives of the financial inclusion policy and identify the main actors involved in its execution. The recent restart of the Central Bank of Ecuador's financial inclusion programme is promising, yet its effects on the target population remain to be identified once more data are available.

However, the Bank has been indirectly implementing its financial inclusion policies through allocation of funds to other public institutions, such as CONAFIPS. The results obtained in the six years during which CONAFIPS has been operating are quite encouraging and the evidence presented above indicates there has been an improvement in access to credit, especially by the popular and solidarity-based sector, the main target of these inclusive programmes.

Finally, the current developments in monetary and financial policies, and proposed changes to the Monetary Code cast a shadow over the future of the financial inclusion policy, and further research on the implications is needed.

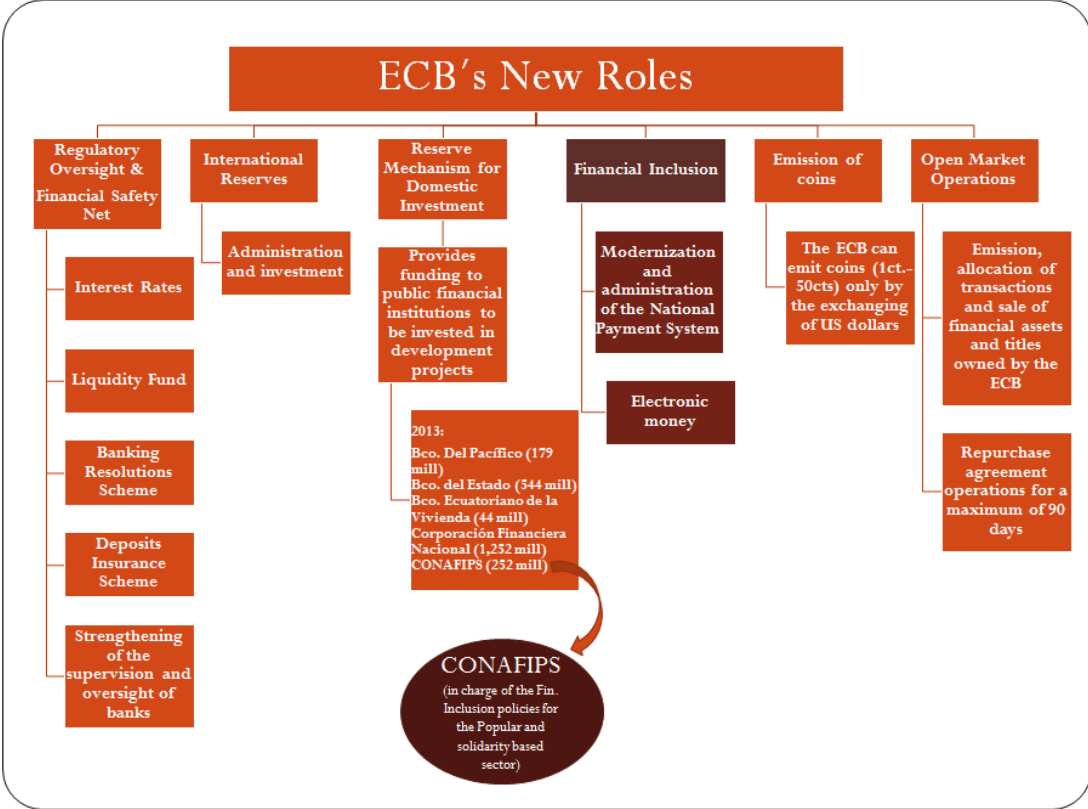
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Appendix: Central Bank of Ecuador – New Roles

Figure 13: ECB's New Roles



Source: Central Bank of Ecuador

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