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Dollarization and financial crime: assessing the vulnerability of emerging economies to money laundering – the case of Ecuador

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ABSTRACT
Dollarisation, implemented in Ecuador in 2000, has contributed to the country's macroeconomic stability; however, it has also generated new vulnerabilities to financial crimes, in particular money laundering. This study aimed to evaluate the impact of dollarization on the vulnerability of emerging economies to this type of crime, taking Ecuador as a case study. A mixed approach was used, combining quantitative and qualitative methods, and a multiple linear regression model (SLO) was applied to analyses the effects of inflation and liquidity on suspicious operations (ROS) during the period 2015–2024. The results showed that both inflation and liquidity have a positive and statistically significant relationship with the number of ROS, jointly explaining 94.5% of their variability. Likewise, a sustained increase in suspicious operations was identified from 2020, which reflects a growing vulnerability of the Ecuadorean financial system. In conclusion, while dollarization has favoured economic stability, it has also limited the ability to respond to emerging financial risks, due to the absence of own monetary instruments and structural weaknesses in financial supervision.

Keywords: financial vulnerability, dollarization, inflation, liquidity, ROS.

1. INTRODUCTION

Dollarisation has been a measure adopted by various emerging economies as a strategy to achieve monetary stability and control persistent inflationary processes (Ojukwu-Ogba&Osode, 2020). This regime implies the total or partial replacement of the national currency by a foreign currency; the US dollar aims to strengthen confidence in the financial system and reduce exchange rate volatility. However, the adoption of this policy also generates structural implications that transcend the macroeconomic sphere (Centurion Vicencio&Villalba, 2025). These include the loss of monetary sovereignty, reduced response capacity to external shocks and exposure to risks associated with international capital flows, including those derived from illicit activities.

In Latin America, Ecuador presents itself as a paradigmatic case. After the financial crisis of 1999, the country adopted official dollarization in 2000 as a mechanism for economic stabilization (Yancha Tuasa, 2023). This decision made it possible to control hyperinflation, restore confidence in the banking system and promote the recovery of growth. However, full integration into the international financial system has implied new challenges in terms of regulation,

control and prevention of financial crimes (Maguchu, 2022). In particular, the widespread use of the dollar in the Ecuadorean economy has increased the circulation of cash and has limited the traceability of transactions, which makes it difficult to detect suspicious operations linked to money laundering (Ponce Andrade et al., 2019).

Globally, the relationship between dollarization and financial crimes has received little academic attention. Existing research has focused on analyzing the

macroeconomic effects of the regime such as price stability, balance of payments or external competitiveness, without comprehensively considering the institutional and regulatory consequences. In this sense, authors such as (Yancha Tuasa, 2023) and (Moreira Basurto et al., 2024) warn that dollarization can amplify the vulnerability of financial systems when control institutions are weak or lack effective mechanisms of international cooperation.

Money laundering is one of the main risks associated with dollarization in economies with high informality. According to the Financial Action Group (GAFI, 2023), dollarized countries have greater difficulties implementing prevention policies, due to the absence of their own monetary tools and the limited capacity to monitor cross-border flows. In the case of Ecuador, the Financial and Economic Analysis Unit (UAFE, 2025) has reported an increase in unusual and suspicious operations in recent years, especially in non-financial sectors, where the regulations still show significant gaps. This context shows a paradox: while dollarization has consolidated the country's macroeconomic stability, it has also generated new forms of exposure to international financial crime (Yancha Tuasa, 2023). Structural weaknesses in governance, transparency and inter-institutional cooperation have limited the effectiveness of anti-laundering and terrorist financing (AML/CFT) controls (Moreira Basurto et al., 2024). As a result, the Ecuadorean financial system faces the challenge of balancing monetary stability with the integrity of its financial flow.

The present research addresses this problem from an analytical perspective, with the objective of evaluating the relationship between dollarization and the vulnerability of emerging economies in the face of money laundering, taking Ecuador as a reference.

The article is structured in three additional sections. The first develops theoretical support on dollarization, illicit flows and financial governance. The second describes the methodology used for documentary and comparative analysis. Finally, the results and recommendations aimed at strengthening the mechanisms of control and institutional cooperation in dollarized contexts are presented.

In summary, this study aims to contribute to the academic debate on the unconventional effects of dollarization, highlighting the importance of understanding it not only as a monetary regime, but also as a phenomenon that conditions the ability of States to face transnational financial threats.

2. THEORETICAL SUPPORT OR LITERATURE REVIEW

Dollarisation has been widely analyzed in economic literature as a strategy aimed at stabilizing economies affected by monetary crises or hyperinflation. According to Chuvakhina et al., (2021), the adoption of a foreign currency seeks to reduce exchange rate uncertainty and discipline fiscal policy, giving greater credibility to the macroeconomic commitments of the State. In this same line, Rossi, (2025) maintains that formal dollarization can generate initial benefits of price stability and confidence recovery, although they warn that these effects tend to depend on the institutional strength of the adopting country.

The loss of control over monetary policy is one of the main structural limitations of the regime. From Echarte Fernández&Martínez Hernández, (2018) argue that dollarization reduces the State's ability to act as a lender of last resort, limits the regulation on the money supply and restricts the supervisory tools on financial flows. These conditions can amplify exposure to external risks and hinder the control of illicit operations, especially in contexts where financial governance capacity is weak or fragmented.

Several studies agree that dollarized economies are more vulnerable to financial crimes due to dependence on international regulations and the lack of national monetary tools. For example, Ojukwu-Ogba and Osode (2020) suggest that the use of the US dollar facilitates the movement of cross-border capital, while Zhang (2024) highlights that cash-based financial systems, typical in dollarized countries, favour informality and make it difficult to detect illicit activities.

The International Financial Action Task Force (FATF) and its regional body, GAFILAT, have warned that dollarized countries face difficulties in complying with international standards for the prevention of money laundering and terrorist financing (AML/CFT). According to the GAFT, (2023), the absence of its own monetary policy limits the supervision of currency movements and makes it difficult to identify illicit flows from abroad. In addition, local financial institutions tend to depend on correspondence systems with foreign banks, which increase reputational risk and exposure to international sanctions for regulatory breaches Javaid&Arshed, (2022).

Various studies have explored the institutional consequences of dollarization in Latin America. Tuasa, (2023) points out that in Ecuador the monetary stability achieved after 2000 has been accompanied by a growing complexity in the financial structure, characterized by the expansion of credit and the inflow of capital of uncertain origin. (LIU et al., 2024) adds that dollarization has encouraged the circulation of large volumes of cash in the informal system, generating difficulties for the supervision of operations and weakening the role of control authorities. These findings coincide with the perspective of Echarte Fernández&Martínez Hernández, (2018), who highlight that the lack of interinstitutional coordination between the Financial and Economic Analysis Unit (UAFE), the Superintendence of Banks and the Attorney General's Office limit the effectiveness of prevention policies.

In terms of comparison, experiences such as those in Panama and El Salvador offer relevant references. In Panama, historical dollarization has coexisted with a highly internationalized banking system, which has generated simultaneous opportunities and risks. According to Arauz, (2025), the country has faced multiple questions from international organizations due to deficiencies in fiscal transparency and in the regulation of offshore companies. For their part, in El Salvador, Rodríguez and Campos (2019) observe that dollarization has stabilized prices but has not prevented the expansion of money laundering through sectors such

as construction and cross-border trade. These cases confirm that dollarization alone does not guarantee institutional solidity or immunity against financial crimes.

From a theoretical approach, the vulnerability of dollarized economies can be analyzed from the framework of international financial governance. This paradigm, proposed by Arevalo Luna&Arévalo Lizarazo, (2023) states that the liberalization of financial markets and global interconnection have reduced the ability of States to control capital flows. Consequently, countries that adopt the dollar as their official currency tend to depend on external regulations and cooperation with jurisdictions of greater financial power. This dependence can generate information asymmetries, less sanctioning capacity and greater exposure to transnational financial crimes.

Likewise, the literature on economic institutionalism Calle&Calle Wong, (2022) emphasizes that the success of any monetary regime depends on the quality of the institutions that accompany it. In contexts where the legal framework is weak and administrative transparency is limited; dollarization can consolidate nominal stability without guaranteeing the integrity of the financial system. Thus, the effectiveness of anti-laundry policies depends not only on current legislation, but also on the State's ability to implement mechanisms for supervision, interinstitutional cooperation and accountability.

In summary, the reviewed studies reveal that dollarization is a multidimensional phenomenon whose effects go beyond macroeconomic stability. Its interaction with financial crimes is explained by a combination of structural factors: the loss of monetary autonomy, the integration into global financial networks, the weakness of the regulatory frameworks and the informality of the economic system. The Ecuadorean case reflects this complexity, by showing how a successful model in terms of price stability can coexist with a growing exposure to money laundering and financial corruption.

3. METHODOLOGY

3.1. General Approach of the Study

This study adopts a mixed-methods approach, combining both quantitative and qualitative methods (Creswell&Plano Clark, 2018). The research is non-experimental, descriptive, and comparative. The hypothesis posited is that an increase in liquidity and inflation enhances the vulnerability of the Ecuadorian financial system to suspicious transactions (ROS).

3.2. Econometric Model

In the first phase, a Multiple Linear Regression (OLS) model will be used to analyze the relationship between macroeconomic variables (inflation and liquidity) and the number of suspicious transactions (ROS), considered as an indicator of financial vulnerability. The data obtained will be analyzed using an econometric model with the statistical software R (version 4.5.1), applying model adjustment through the R^2 value.

The proposed econometric model is expressed as follows:

$$\mathrm{ROS}_t = \alpha + \beta_1 \mathrm{Inflation}_t + \beta_2 \mathrm{Liquidity}_t + \epsilon_t$$

Where:

ROS_t : Represents the annual number of suspicious transactions

$\mathrm{Inflación}_t$: The annual inflation rate

$\mathrm{Liquidez}_t$: The liquidity level of the financial system

ϵ_t: The random error term

The estimated coefficients (β_1 and β_2) will be interpreted in terms of the marginal impact of each explanatory variable on the dependent variable (ROS). Statistical significance will be assessed at a 95% confidence level. This model follows the methodological approach of Javaid&Arshed (2022), who apply multiple linear regression techniques to analyze money laundering behavior in emerging economies.

3.3. Construction of the Financial Vulnerability Index (FVI)

The FVI synthesizes the dimensions of inflation, liquidity, and ROS through linear normalization (0–1) and a weighted average. This indicator allows for the observation of the evolution of financial risk over time and complements the results from the OLS model, which will be performed using the following expression:

$$Z_i = \frac{X_i - \min(x)}{\max(x) - \min(x)}$$

Where:

Z_i : The normalized value in the range of 0 to 1

X_i: The value of the variable

$\min(x)$: The minimum value of the variable in the dataset

$\max(x)$: The maximum value of the variable in the dataset

3.4. Qualitative Component

The documentary analysis will review official documents such as the Organic Law on Money Laundering Prevention, the Comprehensive Organic Criminal Code (COIP), and evaluations from GAFILAT, as well as recent academic literature on financial governance and dollarization (Moreira Basurto et al., 2024).

4. RESULTS AND DISCUSSION

Table 1 presents the results of the OLS model for the period 2015–2024, showing a high level of fit (R^2 = 0.9457; adjusted R^2 = 0.9302), indicating that94.5% of the variability in ROS can be explained by fluctuations in inflation and liquidity in the financial system. Liquidity ($\beta_2 = 0.178$, $p < 0.001$) shows a positive and significant effect, while inflation ($\beta_1 = 711.22$, $p = 0.035$) also displays a positive relationship. The negative intercept ($\beta_0 = -8{,}796.04$) suggests that, in the absence of inflationary or liquidity pressures, the number of ROS would tend to be low.

These results reinforce the hypothesis that macroeconomic factors such as inflation and liquidity have a significant impact on Ecuador's financial vulnerability, particularly in relation to the increase in suspicious transactions (ROS). The proposed multiple linear regression model indicates that both inflation and liquidity present a positive and significant relationship with the number of ROS during the period 2015–2024. Moreover, the high model fit suggests that nearly all variability in ROS can be attributed to these two explanatory variables.

Table 1: Results of the Multiple Regression Model on Inflation and Liquidity in Suspicious Transactions (ROS) in Ecuador (2015–2024)

Parameter	**Estimate**	**Standard Error**	**t-value**	**p-value**	**Significance**
Intercept (β_0)	-8.796e+03	1049.00	-8.385	0.0000675	***
Inflation (β_1)	7.112e+02	273.30	2.602	0.0353	*
Liquidity (β_2)	1.780e-01	0.017	10.416	0.0000163	***

Statistic	**Value**
R^2	0.9457
Adjusted R^2	0.9302
Residual Standard Error	761.3
F-statistic	60.96 (p = 3.73e-05)

Note: The significance of the parameters has a highly significant effect on ROS ($p<0.001$).
Source: Own elaboration based on data from BCE and UAFE, 2015–2024.

The results suggest that imbalances in prices and the availability of money within the financial system not only affect macroeconomic stability but also intensify risks related to money laundering and illicit capital circulation. As Zarate&Manrique Rodriguez (2025) argue, persistent inflation tends to distort purchasing power and cost structures, encouraging the search for informal or illegal financial mechanisms as a way to preserve value. Similarly, Rohaeni et al. (2024) highlight that increased market liquidity facilitates fund movements without productive backing, creating favorable conditions for suspicious financial transactions. These findings align with prior research in emerging economies, warning that monetary expansion and price instability generate structural gaps in financial control systems, reducing transparency and oversight capacity. In dollarized countries like Ecuador, the lack of autonomous monetary policy limits the state's ability to respond to inflationary shocks or excess liquidity, thus weakening financial control mechanisms.

Figure 1 illustrates that the observations are evenly distributed around the horizontal axis without exceeding the influence limits defined by Cook's curves. Observations 2, 7, and 10 show the highest leverage values, although none exceed the critical threshold (Cook's $D<1$). This indicates that the model is not affected by outliers, and that the estimated coefficients are stable. Consequently, the results obtained from the multiple linear regression are reliable for interpreting the effect of inflation and liquidity on suspicious transactions (ROS) in the Ecuadorian financial system.

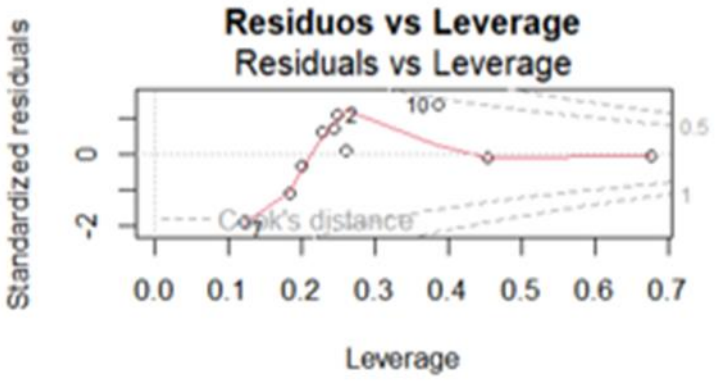

Figure 1: Source: Own elaboration based on UAFE data (2024).

In addition, the diagnostic of model influence confirms the stability and reliability of the estimated coefficients. This suggests the absence of disproportionate influence by individual observations, reinforcing the statistical

validity of the results. However, as Javaid & Arshed (2022) note, the interpretation of linear models should consider each economy's institutional and structural particularities, especially in dollarized or financially informal contexts.

Figure 2 illustrates the temporal evolution of the number of suspicious transactions reported between 2015 and 2024. A sustained upward trend is observed, especially from 2019 onward. Between 2015 and 2018, reports remained below 300 annual cases, while from 2020 a substantial increase occurred, reaching over 7,600 cases in 2024.

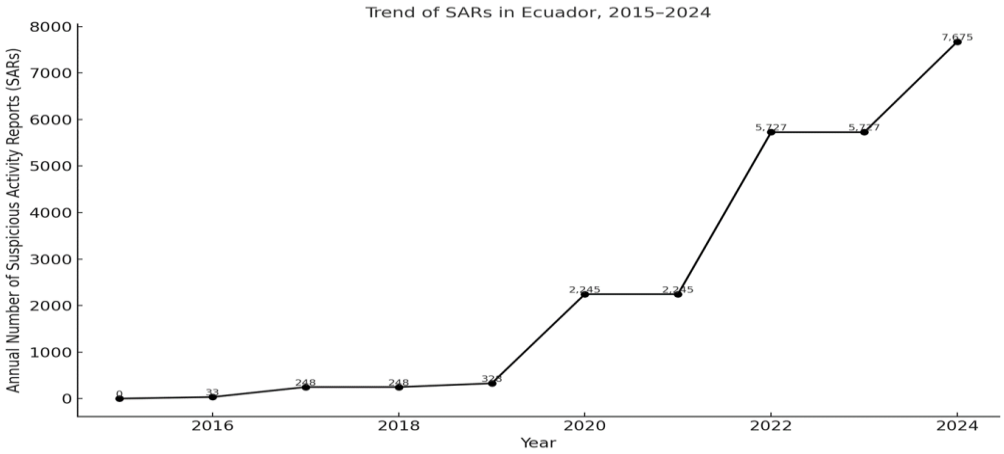

Figure 2: Trend of the number of suspicious transactions (ROS) in Ecuador, 2015–2024

This marked increase coincides with a period of national economic reconfiguration characterized by post-pandemic effects, capital flow reactivation, and the implementation of new financial monitoring reforms (Jorge-Montalvo et al., 2020). Although this could reflect improved institutional detection capacity, it may also reveal structural weaknesses that heighten financial vulnerability (Turksen et al., 2024). As Arauz (2025) and Drenik&Perez (2021) document in similar contexts such as Panama, stricter monitoring policies may lead to an increase in reports, showing that better controls can aining high through 2024.

coexist with expanding informality and sophisticated illicit operations.

Figure 3 shows the behavior of the Financial Vulnerability Index (FVI), constructed by normalizing inflation, liquidity, and ROS. The index ranges from 0 to 1, with higher values indicating greater exposure to financial risks. Between 2015 and 2018, the FVI remained low (0.10–0.35), while from 2020 onward, it experienced rapid growth, peaking in 2022 (≈ 0.83) and rem

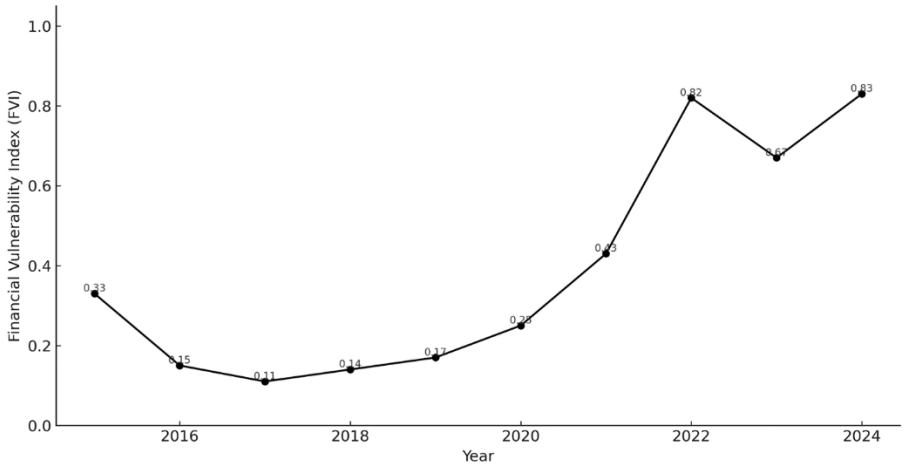

Figure 3: Financial Vulnerability Index (FVI) in Ecuador, 2015–2024

The FVI reveals an accelerated increase in Ecuador's financial fragility, consistent with findings from Moreira Basurto et al. (2024), who argue that dollarized economies exhibit greater vulnerability when not accompanied by sustained structural reforms or strengthened regulation. The increase in FVI serves as

an early warning of systemic exposure to risk, exacerbated by dependence on international monetary policy (Alonso-Alvarez& Molina, 2023) and the proliferation of informal financial systems (Drenik & Perez, 2021). This dynamic restricts Ecuador's capacity to respond to global shocks—such as U.S. Federal Reserve interest rate changes—making the economy more susceptible to external pressures.

Furthermore, the persistent rise in the FVI supports the interpretation that Ecuador's financial vulnerability arises not only from external conditions but also from internal structural weaknesses such as dollarization, limited productive diversification, and weak inter-institutional coordination (Oyadeyi et al., 2024). These findings highlight the urgent need to strengthen financial transparency policies, improve risk monitoring, and enhance financial intelligence cooperation.

Figure 4 presents the means and standard deviations of Inflation, Liquidity, and ROS, revealing clear differences in dispersion among these variables. Inflation shows low variability (mean ≈ 0.97; SD = 0.93), reflecting relative price stability. In contrast, Liquidity demonstrates high volatility, with a maximum exceeding 83,000 and a standard deviation of 14,925.1, underscoring its role as a key driver of financial vulnerability. Meanwhile, ROS exhibits relative stability but with pronounced peaks potentially linked to policy or institutional changes.

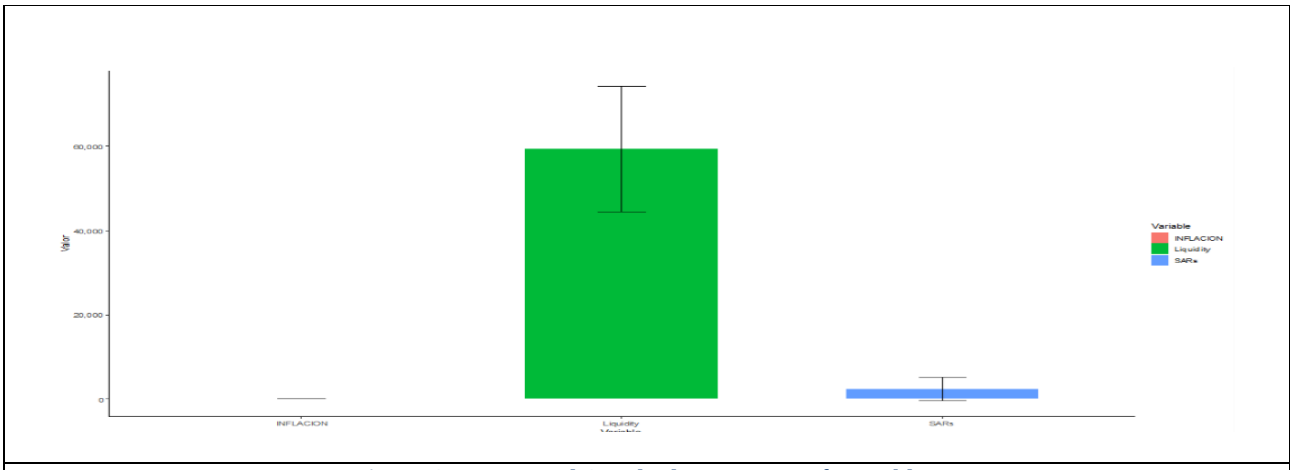

Figure 3: Means and Standard Deviations of Variables.

This dispersion pattern reinforces the model's empirical findings: inflation and liquidity jointly explain fluctuations in financial vulnerability. The greater variability of liquidity implies that rapid monetary fluctuations significantly impact financial behavior, as observed in similar dollarized economies (Zhang, 2024). This relationship suggests that Ecuador's monetary rigidity under dollarization contributes to financial fragility by reducing responsiveness to liquidity surges.

Finally, the study underscores the mixed nature of Ecuador's financial behavior. On one hand, the increase in ROS suggests improvements in control institutions such as UAFEand the Superintendence of Banks; on the other, it reveals persistent exposure to untraceable capital flows (Dua&Verma, 2024). This duality calls for enhanced early-warning systems and advanced analytical technologies to narrow the gap between detection and prevention (Deng et al., 2023). Future research should integrate structural time-series models (VAR, VECM) and machine learning approaches (Amjad et al., 2022) to explore non-linear dynamics, causality, and predictive vulnerabilities.

5. CONCLUSION

The study confirmed that both inflation and liquidity had a significant impact on the increase in suspicious transactions (ROS) in Ecuador between 2015 and 2024. The results showed a positive and significant relationship, with an inflation coefficient of 711.22 ($p = 0.035$) and a liquidity coefficient of 0.178 ($p<0.001$). This highlighted how increases in inflation and liquidity increased the vulnerability of the Ecuadorian financial system to money laundering, emphasizing the importance of monitoring these economic indicators in dollarized economies.

An upward trend in suspicious transactions was observed, especially starting in 2020, when reports exceeded 7,600 cases in 2024, a substantial increase from previous levels. This rise not only reflected greater emphasis on detecting illicit activities but also a more complex economic context. The study suggested that the vulnerability of the Ecuadorian financial system had increased, exposing the country to a greater risk of illicit activities

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The Financial Vulnerability Index (FVI) showed a significant rise, increasing from a range of 0.10–0.35 between 2015 and 2018 to a peak of 0.83 in 2022, indicating a high level of exposure to financial risks. This increase reflected not only the effects of inflation and liquidity but also the growing informality in the economic system, which hindered the traceability of financial flows. The lack of structural reforms and the weakening of control institutions contributed to this growing vulnerability.

The research confirmed that, while dollarization helped stabilize the economy, it also increased the vulnerability

of the Ecuadorian financial system to money laundering. The lack of monetary sovereignty and reliance on international monetary policies made it difficult to control financial flows, fostering informality and illicit activities. These findings underscored the need to strengthen regulatory frameworks and control institutions to mitigate these risks in dollarized economies.

The study suggested that future research should consider other macroeconomic factors, such as interest rates or fiscal policies, to assess their influence on financial vulnerability in dollarized economies. Additionally, it was recommended to study in detail the policies implemented in other dollarized countries, such as Panama and El Salvador, to identify best practices in the fight against money laundering and strengthen international cooperation in monitoring illicit activities.

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