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## ECUADOR WEEKLY REPORT®

## ECONOMIC INDICATORS

For the week of January 21– January 25, 2012

Ecuadorian Global Bonds (January 25, 2012)

### Taxing Times

Under president Rafael Correa, in office since January 2007, tax collection has grown sharply, totaling \$47.91 billion, more than double the \$20.32 billion collected 2001-2006, according to a report this month from the tax service (SRI). Tax collection reached a record last year, coming in at \$11.27 billion, up 17.9% from \$9.56 billion in 2011. The result topped the target of \$10.56 billion by 6.7%, and will certainly by far outpace gross domestic product growth, as it has consistently under this administration (see chart and below). While the SRI appears to be having increased success in combating evasion, structurally, little has changed from past administrations, i.e. most revenue continues to come from indirect taxation.

Part of last year's increase in taxes stemmed from wholly new taxes that went into effect in 2012. New "green" taxes on cars, increasing those on gas guzzlers, brought in \$96.72 million. But these taxes fail to impede pollution. Because they make vehicle ownership rather than consumption more expensive, owners have been handed an incentive to drive more, thus likely raising demand for subsidized diesel and gasoline. A new 2-cent tax on plastic bottles, also

	BID	ASK
Global 2015	103.06	104.99
Global 2030	28.13	32.13

### BCE International Reserves In million US\$

Apr 2012	3.787,39	12.20%
June 2012	3.930,92	3.79%
Aug 2012	4.218,81	7.32%
Oct 2012	4.033,19	-4.40%
18 Jan 2013	3.698,05	-38.44%

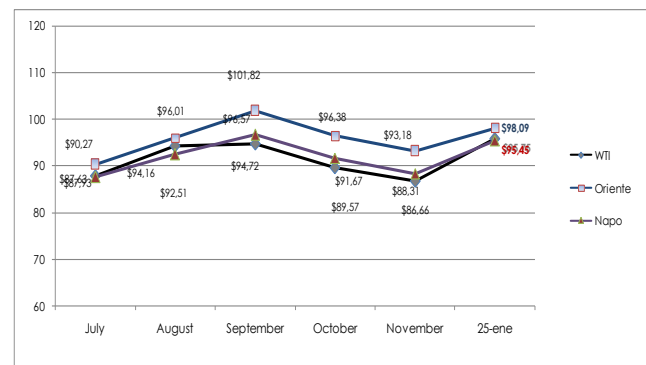
### Inflation

December 2012	-0.19%
Year to Date	4.16%
Year on Year	4.16%

### Banks – Short and long term Deposits In million US\$

Aug 2012	11.795,0	2.41%
Sep 2012	11.705,9	-0.75%
Oct 2012	11.855,7	1.28%
Nov 2012	11.684,9	-1.44%
21 Dic 2012	12.009,6	2.77%

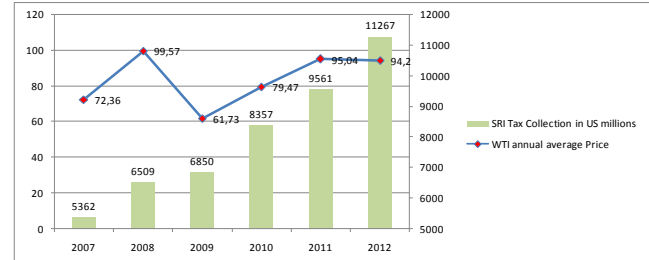
### Ecuadorian Oil Export Prices (US\$ per barrel)



a “green” tax, provided \$14.87 million. The populist president pledged to have machines installed in supermarkets to collect the bottles and return the cash, but these have yet to appear, hence the tax fails to fulfill the pledge of neutrality for citizens' expenses. These taxes account for just 1% of the total however, and environmentalists report some increase in recycling of plastic bottles thanks to the tax.

Among other segments, taxes on foreign assets dropped slightly to \$33.26 million from \$33.68 million a year earlier. The simplified small-business income tax system (RISE) registered a 28.4% jump to \$12.22 million from \$9.52 million. But the lion's share of taxes still came from consumption taxes, conflicting with the administration's stated goal of redistributing wealth through progressive taxation. Income tax payments did rise considerably to \$3.39 billion, up 9% from \$3.11 billion, but well below the overall increase and accounting for 30.7% of the total. In 2008, income tax actually accounted for a substantially higher share of taxes, totaling 51.2%, or \$3.1 billion out of \$6.05 billion. Consumption taxes in 2012 meanwhile reached \$6.15 billion, including \$648.5 million in “special consumption” categories – mainly alcohol and tobacco – whose increase in punitive taxes helped that category to rise 5% from \$617.9 million in 2011, a year in which overall consumption taxes came in at \$5.58 billion. Overall, consumption taxes accounted for 54.6% of the tax take. The controversial currency export tax (ISD) more than doubled to \$1.16 billion in 2012 from \$491.42 million, leading this proxy for capital flight to account for 10.3% of the entire tax take. According to the SRI, company payments represent more than 99% of this tax.

Fines also registered a significant rise, up 20.6% to \$59.71 million from \$49.53 million, providing evidence in support of SRI director Carlos Marx Carrasco's claim that tax evasion has fallen to 20% in 2012, compared with 49% in 2007 and 61% in 2006. The increase in tax collections has been more consistent than the moves of oil prices (see chart), though oil-funded government spending has played a key role in generating taxable income. Generally, even before Correa's first inauguration six years ago, the SRI was considered the best-managed public institution in the country, although suffering from a complex tax system. A torrent of new regulations amid 10 changes to the tax code since 2007 has made it significantly more tortuous to navigate. Critics say the frequent changes and complexity have provided a disincentive to private investment.



Sources: Servicio de Rentas Internas (SRI); Economagic; Economic Time Series Page

Perhaps to dispute this charge, Carrasco also compared Ecuador's tax system with those of Colombia and Peru. According to his data, at 22%, the corporate income tax in Ecuador is far lower than those of the neighbors; Colombia charges 33% and Peru 30%, while personal income tax rates are similar. Neither of the neighbors tax currency outflows or imposes a 70% windfall tax on oil and minerals (although, at current prices, Ecuador isn't charging them). Meanwhile, taxes in Peru that don't exist in Colombia or Ecuador include a special mining

tax and, a temporary net asset tax, as well as a \$15 tax to develop tourism. Colombia charges an asset tax. Officially, Ecuador doesn't, but private-sector analysts count the minimum corporate income tax payment as well as the "green" vehicle tax as asset taxes.

Oddly, Carrasco included the obligatory distribution of 15% of company net profits to employees as a tax as part of the tax comparison. Normally, the SRI insists that taxes amount to just 15.3% of GDP to justify that there is still ample room to increase taxes. This however ignores the profit distribution as well as numerous other obligatory payments, including local taxes. With government spending approaching half of GDP – extraordinarily high for a developing country – the debate about how many more taxes the private sector can withstand is anything but marginal.

### **Not an Outperformer**

In the third quarter of 2012, GDP increased 1.5% from July-September, the first quarterly increase since the first quarter of 2011. On the year however, GDP grew 4.7% on the year, only about half the pace of the 9.1% registered in the same quarter 2011. Under the Correa administration, GDP growth continues linked to cyclical events. While slightly above the average growth rate for the region in 2007-2011, it remains too low to significantly reduce poverty at a sustained rate.

Planning Secretary Fander Falconí was sufficiently incensed by local media pickup of a chart on the Web site of *The Economist* this month to protest against the British newspaper's ranking of Ecuador as the worst of Latin

American countries to be born in this year and ranking number 65 out of 80 countries. Falconí's ire stemmed from the fact that much of the data came from a 2006 survey, before the advent of the "Citizens' Revolution." While the data are in fact somewhat old, in one element of the survey, which accounts for two thirds of the ranking, Ecuador has tended to underperform: the growth of the economy. In his comments on the ranking, Falconí emphasized that Ecuador has grown above the average of Latin America under Correa, considering the most recent available data. This is true, but only shows part of the picture. In 2007-2011, Ecuador's GDP grew an average 4.2%, compared with 3.6% for the region as a whole, according to the United Nations' Economic Commission on Latin America and the Caribbean (ECLAC). Ecuador however fails to consistently outperform the region. Comparing only the first four years of Correa's administration – a normal presidential term – shows growth averaging 3.2%, below the region's 3.4% for the same period. Compared with the direct neighbors, Ecuador has actually lost ground. GDP growth in Colombia averaged 5.5% in the period and in Peru, 7.1%, outpacing Ecuador.

The country comes out still worse when population growth is factored in. In 2007, Ecuador's GDP per capita stood at \$3,675.9, amounting to 78.9% of Colombia's \$4,661.4 and 96.9% of Peru's \$3,792.8. Slow growth has left Ecuadorians relatively poorer than the neighbors. In 2011, Ecuador had reached GDP per capita of just \$5,323.3, leaving it at 75.2% of Colombia's \$7,074.6 and 87.2% of Peru's \$6,105.7. Compared with the region overall, Ecuador is also falling behind. In 2006, Ecuador's GDP per capita

amounted to 55.3% of the region's average \$6,641.8, edging even lower to 55.2% in 2011 compared with the \$9,644.4 average for Latin America, showing that the country is becoming relatively poorer. And Ecuador – just like much of the region – doesn't look set to reach sustained growth of around 7% for a long period of time. That would allow many of those who remain poor to hurdle the poverty line and the country to escape the “middle income trap” saddling numerous developing countries. Despite the increase in taxes noted above, which could indicate improved redistribution, the poverty rate fell just 1.3 percentage points in 2011 to 27.3% from 28.6% a year earlier, according to INEC, the national statistics agency. As economist Vicente Albornoz noted in a column in *El Comercio*, poverty reduction under Correa continues to underperform that of the previous administrations since 2000. He added that the sharp drop in poverty in 2010, a year of 6.5% GDP growth, proved poverty reduction isn't necessarily more difficult following several years of economic stabilization and growth as seen in Ecuador after the introduction of the dollar. Any celebration of GDP growth under Correa – of course a weak proxy for development – is thus misplaced.

Regarding July-September's data, government spending grew 4.5% on the quarter, the fastest increase among components of the demand side. Combined public and private gross fixed capital formation (GFCF) came in next, up 1.7%, consumption rose 1.1% and imports gained 0.4%. Exports dropped 0.3% on the quarter amid the fall in the price of oil. Consumption contributed 0.7 percentage points to the 1.5% quarter-on-quarter growth, followed by 0.5 points from government consumption and

0.4% from GFCF. Annually, GFCF has remained above 12% since the second half of 2010. Import growth also continues high, registering an 8.5% rise on the year and generally increasing since the third quarter of 2011. Household spending however continued to cool, showing a third straight annual decline since the 6.8% rise of the fourth quarter of 2011, coming in up 5.3% on the year and up 1.1% on the quarter. Commercial activity unsurprisingly has also grown more slowly, with growth rates declining since the third quarter of 2011 and reaching 4.5% on the year last July-September, the lowest level since the final quarter of 2009.

Meanwhile, construction growth was still high at 11% on the year, but it has shown a clear deceleration from the unsustainable rate that peaked at 27.3% annual in the third quarter of 2011. Financial services shrank 0.1% on year, a steep decline from the three-year peak of 13.6% in the same quarter of 2011.

For this year, the economics ministry has estimated GDP growth of 3.9% after 4.8% in 2012. Again, the moderate growth rate will keep Ecuadorians from catching up with the rest of the region, let alone industrialized nations.

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