

Schützhofer, Timm B.

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## Ecuador's fiscal policies in the context of the citizens' revolution: a 'virtuous cycle' and its limits

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# Ecuador's Fiscal Policies in the Context of the Citizens' Revolution

## A 'Virtuous Cycle' and its Limits

*Timm B. Schützhofer*

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**Timm B. Schützhofer** holds a BA in Political Science and an MA in Global Political Economy from Kassel University, where he is currently pursuing his PhD. In his thesis, he analyses fiscal policy and broader development challenges of resource-dependent countries and focuses on Ecuador.

Email: [schuetzhofer@student.uni-kassel.de](mailto:schuetzhofer@student.uni-kassel.de)

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© Deutsches Institut für Entwicklungspolitik gGmbH  
Tulpenfeld 6, 53113 Bonn  
☎ +49 (0)228 94927-0  
📠 +49 (0)228 94927-130  
Email: [die@die-gdi.de](mailto:die@die-gdi.de)  
[www.die-gdi.de](http://www.die-gdi.de)

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## Abbreviations

AIMA	Asociación Ecuatoriana de Industriales de Madera
Alianza PAIS	Alianza Patria Activa i Soberana
ANDES	Agencia Pública de Noticias del Ecuador y Suramérica
BCE	Banco Central del Ecuador
CDES	Centro de Derechos Económicos y Sociales
CEF	Centro de Estudios Fiscales
CEOSL	Confederación Ecuatoriana de Organizaciones Sindicales Libres
CONAIE	Confederación de Nacionalidades Indígenas del Ecuador
CREO	Movimiento Creando Oportunidades
CSE	Confederación Sindical del Ecuador
DGR	Dirección General de Rentas
ECUARUNARI	Confederación de Pueblos de la Nacionalidad Kichwa del Ecuador
ETAPA-EP	Empresa Pública Municipal de Telecomunicaciones, Agua Potable, Alcantarillado y Saneamiento
EXPOFLORES	Asociación de Productores y Exportadores de Flores del Ecuador
FED	Federal Reserve System
FENOCIN	Confederación Nacional de Organizaciones Campesinas, Indígenas y Negras
FLACSO	Facultad Latinoamericana de Ciencias Sociales
GDP	Gross domestic product
IADB	Inter-American Development Bank
IMF	International Monetary Fund
MCPE	Ministerio Coordinador de la Política Económica
MCPEC	Ministerio de Producción, Empleo y Competitividad
MINEDUC	Ministerio de Educación
MINFIN	Ministerio de Finanzas
MITRAB	Ministerio de Trabajo
MRNNR	Ministerio de Recursos Naturales No Renovables
NRF	Natural resource fund
OECD	Organisation for Economic Co-operation and Development
PRE	Partido Roldósista Ecuatoriano
PSC	Partido Social Cristiano
SENPLADES	Secretaría Nacional de Planificación y Desarrollo
SRI	Servicio de Rentas Internas
UNCTAD	United Nations Conference on Trade and Development
USD	United States dollar
VAT	Value added tax
WEF	World Economic Forum



## Summary

Resource-dependent countries are considered to have major difficulties in developing strong taxation systems and sound fiscal policies. Both theoretical assumptions and empirical studies hint at a negative relation between resource revenues and the ability to tax. However, Ecuador has increased tax revenues in times of relatively high resource revenues. Contrary to what is expected based on rentier state theory, I argue that in Ecuador, increasing resource revenues have played a positive role in facilitating higher and more progressive taxes. This is because the state has become more autonomous of business elites.

The research I have conducted shows that while oil-revenues have not been the initial cause for the Correa government's motivation to increase taxes – not least on economic elites – these revenues have indeed been an important factor in the government's medium-term success. The increased fiscal space has strengthened its ability to invest while increased public investments have had a positive impact on the perception of state capacity (Wolff, 2016). A key question is whose perception of state capacities has become more positive? In a standard fiscal contract model, the focus must be on high-income earners who pay most of the direct taxes. Taxpayers accept higher taxes as government activities are perceived as beneficial to them. In this regard, the World Economic Forum's (WEF) Executive Opinion Survey shows better results. However, these results cannot be considered as enabling factors for fiscal policy changes, but rather as resulting from them. The main point is an improved perception of state capacities among the general population, which has politically legitimated the more decisive role for the public sector in the country's development strategy.

In this paper, I analyse a number of different phases in fiscal policy-making in the context of Ecuador's Citizens' Revolution. In doing so, I examine overlapping phases of what I have denominated the 'virtuous cycle' from Correa's first election in 2006 to his second re-election in 2013. In short, the appropriation of an increasing share of oil revenues has facilitated the improvement of state-society relations and thus the government's ability to enforce tax payments. A promising result of my analysis is that mobilising oil-rents for investments can be politically rewarding and help to sustain increasing tax collection levels. Overall, the analysis shows that a negative impact of resource-revenues on taxation is not an automatism. Finally, I also consider the current difficulties in continuing down the path towards the improvement of Ecuador's taxation system in times of a much lower oil price.



## 1 Introduction

Despite advances since the turn of the millennium, Latin America remains a highly unequal world region in terms of income distribution (Bird & Zolt, 2013; Wehr, 2011). Taxation systems tend to provide insufficient revenues and are often regressive. While Latin American countries collect nearly as much value added tax (VAT) in per cent of gross domestic product (GDP) as OECD member countries, there is a large gap when income and especially personal income taxes are concerned (Frigenti, 2012, p. 4; Stein & Caro, 2013). In the short term, resource rents might be perceived as a welcome alternative to solve pressing social problems without the need to increase taxes on domestic elites (Svampa, 2013). However, such revenues are finite and volatile. The challenge remains to develop progressive tax systems that generate stable revenues. In view of this challenge, the present study focuses on recent experiences from Ecuador.

Stein and Caro (2013) find that Latin America's left-turn has triggered a positive development in this regard, as tax revenues have increased markedly since the region started to shift towards the Left at the turn of the millennium. This shift is taking place in a region where economic elites have enjoyed a disproportionate influence in the policy-making process. The success of such an agenda can also be related to the elites losing their grip on political power (Stein & Caro, 2013). Since the start of Ecuador's Citizens' Revolution<sup>1</sup> in 2007, fiscal policies and especially taxation have been a key priority of the Correa administration. This agenda aims at achieving sufficient tax revenues and making taxation less regressive. It is somewhat surprising that this development should occur in the midst of 'plenty' (Karl, 2007, p. 278) but it might provide an example from which the governments of other oil-exporting countries might learn.

From the perspective of rentier state theory, this focus on taxation is surprising since resource rents are expected to undermine tax efforts (Acosta, 2012; Besley & Persson, 2014; Di John, 2006; McGuirk, 2013; Peters, 2014; Stevens & Dietsche, 2008; Weyland, 2009). Furthermore, Ecuador has for long been one of the region's worst performers with regard to tax collection (Gómez Sabaini & Jiménez, 2012; Paz y Miño Cepeda, 2015).<sup>2</sup> Nonetheless, Ecuador has increased tax revenues and made taxation less regressive. The emphasis on taxing domestic elites also represents a core difference to the practice of the military-ruled developmental state of the 1970s (Acosta, 2012; Dunning, 2008). Herein, Ecuador differs from other resource-dependent countries in the region that are governed by the Left as is the case for Venezuela and Bolivia.<sup>3</sup>

At the time of writing, high oil prices seem a thing of the past; I shall thus also comment on the sustainability of changes under more adverse economic circumstances. My analysis

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1 The term 'Citizens' Revolution' is used for the ongoing process of political and economic change in Ecuador in the context of the Correa presidency since 2007. It also refers to the constitutional process, legislative changes and the aim to construct a development model that leads towards the so-called 'Socialism of Good Living'.

2 Indeed, the country's former military dictator, Rodríguez Lara, still claims that not having collected income taxes was a major advancement during his rule.

3 These countries have focused their efforts solely on appropriating a larger share of resource revenues against the interests of multinational oil-companies. Fairfield (2015) explains that, ironically the rise of the heterodox Left to power ended the efforts to tax domestic elites, while it dramatically increased taxes on foreign elites, namely foreign hydrocarbon firms.

will touch on the reactions to the government's recent reform proposals, while acknowledging that it is still too early to reach final conclusions.

## 1.1 Research question and hypothesis

In the present paper, I discuss the developments in tax policies and tax performance since the start of Ecuador's Citizens' Revolution in 2007. The 2008 Constitution contains rules and guidelines for the fiscal policy field against which the real policy outcomes can be measured. A key concern is to finance permanent expenditures with permanent income in order to be less vulnerable to the volatility of oil revenues and better prepared for periods of low resource revenues.

Exceptions can be made for education, healthcare and the judiciary in extraordinary circumstances (Constitución del Ecuador, 2008, Article 286). Another constitutional goal is to move towards a progressive tax system by focusing on direct taxes (Correa, 2012).<sup>4</sup> Ecuador's explicit policy goals are thus in line with a growing awareness of the need to increase tax revenues from economic elites via more direct taxation (Cornia, Gómez Sabaini & Martonaro, 2012; Fairfield, 2013; von Schiller, 2015), but in stark contrast to the Latin American and former Ecuadorian pattern of regressive and relatively low levels of tax collection. My analysis shall provide empirical evidence on the range of change (Section 4), as well as on the causal factors that have made it happen (Section 5).

The analytical question to be dealt with refers to the following: What conditions and political strategies allowed Ecuador to successfully implement policies aimed at higher and less regressive tax collection in times of high resource revenues?

The negative relation between resource revenues and the ability to tax that is assumed in rentier state theory serves as a starting point for my analysis (Dunning, 2008; Karl, 2004; Moore, 2004). However these assumptions are contradicted by recent advances in Ecuador's fiscal policy arena. I thus take into account other theoretical approaches that might help to explain this finding:

The first is based on the assumption that specific institutional reforms have been implemented in order to counteract the negative effects of resource abundance on taxation. Following this logic, restrictions of government access to resource revenues have triggered a process of bargaining that ultimately led to steps towards a fiscal contract. The fiscal contract paradigm is a strand of fiscal sociology that is focused on the positive effects of an improved relation between government and taxpayers (Timmons, 2005; Moore, 2008). From this perspective, higher tax revenues are related to the better representation of taxpayers within the tax policy process, improved mechanisms of control, and a state that serves the interest of those who finance it with their taxes. The factors just mentioned are expected to increase the willingness of economic elites to pay taxes. From this perspective, the steps necessary to increase the tax-to-GDP ratio can be summed up in the ensuing hypothesis:

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4 The 2008 Constitution includes the principles of generality and sufficiency of taxation and explicitly points to the priority of direct and progressive taxes (Constitución del Ecuador, 2008).

H1: Institutional reforms have restricted government access to resource revenues, thus creating pressure to finance the state via taxes. As a consequence, a process of bargaining has developed, leading to higher tax contributions in exchange for government accountability and taxpayers' participation in fiscal policy decisions. Through this, the state itself becomes more efficient and starts to take decisions in accordance to its self-interest within a prosperous private sector, rather than based on political interests and preferences.

An alternative perspective looks at changes in power relations between the state, economic elites, and non-elite sectors of society. The analysis of tax policy is a test for theories of business power since firms have a common interest in reducing or shifting their individual tax burdens (Quinn & Shapiro, 1991, pp. 851-852). From this perspective, recent tax policy changes in Ecuador could also be the result of increased government autonomy from business elites (Acemoglu & Robinson, 2006; Fairfield, 2013, 2015). In this case, the government is able to increase tax revenues due to a decrease in the structural and/or instrumental power of economic elites. Structural power is also referred to as investment power (see, for example, Fairfield, 2013). Its exercise needs no coordination between the various different actors as it arises from concerns that fiscal policy decisions – such as, for instance, increases in effective tax rates for elites – could have a negative impact on private investments and economic growth. Nonetheless, structural power can also be used strategically, for example in coordinated investment strikes (Culpepper & Reinke, 2014) – a situation which is especially likely in a context where the separation between political and economic power is blurred. Here, the economic success of business elites is often closely related to their political influence. Structural power can be deployed deliberately, while it usually works automatically through the anticipation of policymakers (Culpepper & Reinke, 2014).

Instrumental power is exercised at the political level by “lobbying, direct participation in policymaking, financing electoral campaigns, editorializing in the press, or engaging in various types of collective action” (Fairfield, 2015, p. 28). Fairfield distinguishes between economic elites' own resources, such as cohesion, expertise, media access and money; and relationships with policymakers including partisan linkages, institutionalised consultations, recruitment into government, election to public office and informal ties (Fairfield, 2015, p. 29). It can be assumed that the structural power of business diminishes as high levels of resource revenues are available to the state. While structural power is rooted in the economic position that private sector agents occupy in capitalist societies, non-elite groups can also mobilise resources to influence policy outcomes and, through this, exercise instrumental power (McGuire & Scherrer, 2010; Meyer, 2004). Instead of an increase in state autonomy, state-capture by economic elites could thus also be replaced by the increased presence of popular sector representatives within the state (see Timmons, 2005). Within the limits of a capitalist economy, such a development would only partially affect the structural power of economic elites mentioned earlier.

The case study approach allows me to take an in-depth look at the process of change. I refer to it as a ‘virtuous cycle’ in Ecuadorian fiscal policies. It runs opposed to the expected replacement of tax income by resource rents, which is prominent in rentier state theory. While the perspective summed up in my first hypothesis sees government autonomy generated by resource rents as a cause for a lack of accountability and wasteful public spending, the concern with state capture sees the excessive influence of specific

business sectors on public policy decisions as the main problem. The proposed solutions are thus focused on the enforcement of state autonomy, which is deemed necessary for the implementation of coherent public policies.

In this context, it is important to distinguish between structural and instrumental power. This allows me to analyse the impact of resource revenues on government autonomy from economic elites (structural power) vis-à-vis the importance of political developments (instrumental power). Based on these, I present two hypothesis related to the origins of government autonomy.

H2a: Based on the structural power perspective, the increase in public revenues from natural resources has affected business investment power because the available resources have allowed the state to implement its own investment programmes, which in turn have led to a more positive perception of the state and higher levels of support for the government. As a consequence, the Correa government was able to implement tax reforms against the opposition of economic elites and to take a more robust stance against tax evasion.

H2b: According to the instrumental power perspective, the Citizens' Revolution has caused a process of political and institutional change, which has weakened the political power of economic elites, especially as it has undermined established relations to the political system. It has thus been possible to take tax policy decisions despite the opposition of business representatives and to establish autonomous public institutions and a merit-based civil service. These developments have allowed the Correa administration to appropriate resource revenues for the public sector, while also increasing the tax-to-GDP ratio.

While the concepts of structural and instrumental power refer to distinct mechanisms, they are also interrelated. As pointed out above, the expectations of policymakers are an important source of the structural power of economic elites. This power resource is not apolitical, as it depends on the access of business representatives to policymakers and on premises that are made based on the influence of various different economic schools. Structural power is expected to increase in times of economic turmoil or when recession looms, as governments attempt to encourage investments, for instance by expanding tax incentives. In this situation, economic elites can also increase their instrumental power as governments tend to be more interested in dialogue and therefore more attentive to their policy suggestions.

## 1.2 Structure of the discussion paper

Following the Introduction, the second section encompasses the conceptual and theoretical framework of my analysis. In Section 3, I outline my empirical and methodological approach. Subsequently, I provide an empirical summary of changes in regard to fiscal policies and both resource and non-resource revenues in Section 4. Here, I also take into account Ecuador's recent political economic history since the so called 'boom petrolero' of the 1970s. After this empirical overview, I then examine fiscal policies in the period from 2007 to 2013, focusing on taxation in Section 5. I refer to these developments as a 'virtuous cycle'. In Section 6, I turn to an analysis of tax policy-making after the 2013 election, discussing obstacles and possible strategies in taking further steps towards a more just tax system in a period of low resource revenues. Finally, I present my conclusions in Section 7.

## 2 Conceptual and theoretical framework

The ability to tax positively correlates with economic development (Di John, 2006; Moore, 2008). The ability of developing countries to raise taxes is often limited by a large informal sector, external shocks and volatile GDP growth (Di John, 2006). Weak fiscal systems are especially prevalent in resource-dependent and commodity-exporting countries, such as Ecuador. In the present section, I turn to two different theoretical perspectives that might help to explain Ecuador's ability to strengthen its tax system in the context of the Citizens' Revolution since 2007.

In the upcoming subsection, I focus on the fiscal policy dimension of the so-called 'resource curse' (2.1). This includes a look at the mechanisms that relate high endowments in natural resources to weak fiscal systems. I focus mainly on the impact of non-renewable, point-source resources that enable governments to appropriate significant rent revenues. I also touch upon the broader debate about the relation between economic structure and the ability to tax. Thereafter, I turn to an analysis of various different theoretical approaches on which the above formulated hypotheses are based.

The first approach develops suggestions of institutional reform based on fiscal sociology perspectives that are often discussed within the debate on the fiscal policy dimension of the 'resource curse' (2.2). These institutional reforms are focused on setting off the negative impacts of available resource revenues on taxation. In accordance with this strand of fiscal sociology, it is assumed that the emergence of modern fiscal states is caused by their need to obtain tax revenues. It is thus expected that a fiscal contract between the government and tax payers emerges as governments need to bargain for tax revenues by offering taxpayers better mechanisms of control and participation in fiscal policy decisions. Accordingly, the main challenge in a resource state context is to shield resource revenues from government access, thereby disciplining a previously unaccountable state. In turn, increased accountability leads to trust in public institutions and thus an increased willingness to pay taxes.

The second approach is a political economy perspective on taxation. Here, the main factor is increased state autonomy from business elites (see Subsection 2.3). Rather than deficient societal control, a lack of government autonomy from business elites represents the main obstacle for higher tax revenues. Hereby, I distinguish between the structural and instrumental power of economic elites: the former is closely related to the availability of resource revenues, which decrease the state's dependence on taxes and the economy's reliance on the private sector; the latter is focused on changes in political power relations.

### 2.1 The 'resource curse' revisited: its fiscal policy dimension

The increase in commodity prices since the turn of the millennium has triggered a renewed debate on the development impact of natural resources in Latin America. Government officials tend to stress the advantages of possessing large amounts of natural resources (Carrasco Vicuña, 2015). This is also suggested by standard economic theory since "large revenue inflows following exports should provide opportunities to invest in projects and programmes that promote development" (Stevens & Dietsche, 2008, p. 56). In opposition to this perspective, the idea of a 'resource curse' in its economic and

political dimensions is often stressed (Acosta, 2012; Altvater, 2013; Weyland, 2009), while others highlight the importance of institutional settings (von Haldenwang, 2011, 2012; Humphreys & Sandbu, 2007; Karl, 2007).

Extractivism not only applies to the oil, gas and mining sectors, but also to agricultural plantations for export production that is usually in private hands. While the former represents the typical situation in rentier states, issues regarding taxation follow from the latter as well. As Burchardt (2012) indicates, outward-oriented economic sectors, with low levels of integration in the domestic economy, tend to resist taxation. In the cases of oil and gas extraction, various different types of arrangements, including state-owned enterprises and various different types of contracts and rules for private, often foreign-owned, oil and gas companies can be applied (von Haldenwang, 2011). Thus, while private actors are not necessarily excluded from the oil and gas resource sectors, the characteristics of these point-source non-renewable resources enable many producer-countries to appropriate a major share of revenues. The high levels of resource revenues and extended access to international loans often lead to a neglect in raising taxes (Herb, 2005; Moore, 2008; Peters, 2014). A key difference between rentier and other states is that high resource rents exempt the former from the “necessity of taxing its own people” (Peters, 2014, p. 64).

The apparent high degree of autonomy does not translate into a development advantage (Stevens & Dietsche, 2008). Bueno de Mesquita and Smith (2011) argue that the availability of labour-free resources, such as natural resource rents instead of taxes, creates incentives for incumbent leaders to suppress coordination goods in order to reduce citizens’ ability to organise politically. Yet, this also reduces

their ability to coordinate economically, resulting in reduced productivity and diminished economic activity. Leaders who rely on taxing productive economic activity to generate the resources needed to reward their ruling coalition find suppressing public goods to be unattractive (Bueno de Mesquita & Smith, 2011, p. 3).

However, when governments rely on labour-free resources such as natural resource rents, the suppression of coordination goods is possible with little if any damage to their revenue (Bueno de Mesquita & Smith, 2011, p. 3). Furthermore, the phenomenon of the ‘Dutch disease’<sup>5</sup> reduces the share of non-resource dependent sectors of the economy and reinforces resource dependence, reducing the taxable income from non-resource sectors.

From the fiscal sociology perspective, taxes cannot simply be imposed (Timmons, 2005). Instead, given the high costs and limitations of coercive enforcement, governments are interested in the cooperation of taxpayers (Moore, 2008). The resulting bargaining process thus commits them to accept institutionalised mechanisms of accountability and consultations in the area of fiscal policy (Moore, 2008). In rentier states, this process is significantly “delayed and skewed, or must occur through other mechanisms” (Karl, 2007, p. 259; Peters, 2014). Instead of the lemma of ‘no taxation without representation’, the principle of ‘no taxation, no representation’ prevails in a rentier state context (Peters, 2014; Ross, 2004). Resource rents are to substitute, instead of complementing, taxes. They create apparently strong states because the reduced necessity to levy domestic taxes makes states less accountable to individuals and social groups. They are “more prone to engage in and

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5 The term ‘Dutch disease’ refers to the consequences associated with a rapid increase of revenues from raw materials, such as a decline of other sectors of the economy as occurred in the Netherlands during the 1960s where the extraction of natural gas led to deindustrialisation.



accommodate rent-seeking and corruption; and less able to formulate growth-enhancing policies” (Di John 2006, p. 8). As governments rely on non-tax revenues, they are less forced to negotiate and interact with their citizens; accountability “and commitment to the common good are at risk” (Moore, 2011, p. 7).

It is argued that the large amounts of ‘unearned’ revenues leads to greater capacities in distributive functions and a large (and inefficient) state-owned enterprise sector, while “functions related to regulation and supervision of the economy and domestic taxation” are less developed (Rosser, 2006, p. 16).

In the best cases, mineral dependence initially contributes to some form of state-building, but even here, the public sector eventually becomes a ‘honey pot’ that lends itself to state capture to the detriment of the state’s efficacy, representative capacity, and sustainability. (Karl, 2007, p. 260)

This leads to a ‘vicious cycle’, since the lack of accountability and fiscal discipline and the inability to promote growth-enhancing policies further undermines citizens’ willingness to pay taxes. In the ensuing subsection, I address possible solutions that are based on the need for fiscal discipline as expressed in my first hypothesis (H1).

## 2.2 From the ‘resource curse’ to a new fiscal contract?

Based on the challenges for resource-dependent countries just described, various measures can be taken both on the revenue and on the expenditure side.

On the revenue side, the main challenge is to establish trustworthy institutions for tax collection. One option is the creation of a semi-autonomous revenue agency as recommended by development cooperation (Di John, 2006; Fjeldstad & Moore 2008; Mann, 2004). According to Daude, Gutiérrez and Melguizo (2012) these institutions help to improve citizens’ perception of tax collectors<sup>6</sup>, which is positively correlated to tax morale and thereby raises the government’s ability to collect taxes. Based on a study at the sub-national level, von Haldenwang, von Schiller and García (2014) argue that these institutions there do indeed have a positive effect on tax collection. Yet, such institutional change depends on the political conditions that allow for a profound reform of a country’s tax administration. According to the lemma of ‘no taxation without representation’, better control mechanisms on the expenditure side could also encourage the payment of taxes (Ross, 2004).

As a ‘paradox of the plenty’ is seen as the root cause of the problem in contributions that suggest a fiscal policy dimension of the ‘resource curse’, solutions may start here. Various prescriptions for policy measures and institutional change can be derived from this premise. A key to solving the problem is seen in disciplining governments’ fiscal policy attitudes. One way of doing this is the isolation of resource rents from the regular budgeting process. For instance, natural resource funds (NRFs) are proposed as a mechanism that helps to restrict expenditures in the present time in order to accumulate for the future. The aim is to smooth spending over the medium term in order to make the

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6 In the Ecuadorian case, the creation of a new, semi-autonomous revenue authority that was initiated in 1997 and completed in 1999 was combined with an almost complete replacement of staff (Romo-Leroux Chávez de Mena, 2000).

economy less vulnerable to volatile resource prices (Humphreys & Sandbu, 2007). Furthermore, governments would start to rely on tax revenues to finance their expenditures. They would need to negotiate with their citizens in order to obtain revenues, which would in turn trigger the institutional changes that guarantee higher levels of government accountability.

These dynamics are questioned by Mick Moore (2011, p. 18), who argues that the assets and profits of such funds

can easily be switched between overseas investments and the domestic economy and fiscal system. Sovereign wealth funds potentially liberate executive authorities from the need to negotiate with domestic taxpayers to obtain revenue, or to explain their expenditures to legislatures and voters.

Otherwise, NRFs represent an attempt to artificially restrict government access to resources and might actually undermine the ability to tax. The fiscal contract hints at a nexus between the willingness to pay taxes and the quality of government spending and of public services (Daude et al., 2012; Moore, 2004, 2007, 2011). Restrictions in government expenditures might tend to lead to a more negative perception of state capacity and thus less willingness to pay taxes, while investments in infrastructure, education and health might trigger a positive perception of state capacity. Furthermore, domestic real investments might be more promising than NRFs.

While the objective to prevent wasteful spending and the creation of an overextended state apparatus is comprehensible, the path from the establishment of NRFs or other restrictions on government spending to an increased willingness to pay taxes appears inconsistent. From the fiscal contract perspective presented here, the willingness to pay taxes and the expectations regarding the use of revenues are related. Daude et al. (2012) point out that, beyond enforcement and the probability of getting caught, the perception of institutions is important, as well as the general support for democracy.<sup>7</sup> In line with the dissatisfied consumer model, a negative perception of health and education services results in lower tax morale (Daude et al., 2012). This assumes a more direct trade of services for revenue. Here,

if a state begins taxing a group, it has strong incentives to provide that group with benefits to maintain that source of revenue, limiting redistribution; conversely, if a state is not taxing a group for some reason (for example, because there is no profit in it), it has no incentive to cater to that group. (Timmons, 2005, p. 532)

The scope for redistribution within a fiscal contract model is thus limited as only economic benefits from high-quality public services and infrastructure can be counted as positive drivers for the elites' acceptance of taxes (von Schiller, 2012). Therefore, social expenditures in public education and healthcare would have to be financed by increasing revenues from indirect taxes that are mainly paid by the middle classes and popular sectors. Increases in direct tax revenues from elites would be closely related to more secure property rights and public infrastructure that is beneficial to these taxpayers (von Schiller, 2012).<sup>8</sup> However, apart from providing direct benefits, the cost of coercion can also

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<sup>7</sup> According to their research, there is a close relation between tax morale and the ability to collect revenue.

<sup>8</sup> In the Ecuadorian case, most members of elites tend to rely on private education and healthcare. As only a small portion of the population passes the threshold for paying personal income taxes, I assume that those obliged to pay the personal income tax and those directly benefitting from better public services, such as healthcare and education, are by in large two separate groups.

be kept low by making credible commitments to citizens, providing direct benefits and giving taxpayers a say over policy and investing in ideology (Timmons 2005, p. 535).

### 2.3 From state capture to government autonomy?

As in the fiscal sociology approach outlined above, political economy perspectives do not see taxation as a mere technical exercise (Di John, 2006). According to Di John and Putzel (2009), taxation provides an important lens for measuring state capacity and the analysis of power and political settlements in a society. "The capacity of states to collect direct taxes (income and property taxes) provides an important window into their power and legitimacy vis-a-vis upper income and middle-class groups" (Di John, 2006, p. 12). The political economy approach focuses on the political struggles that define the tax contribution of elite and non-elite sectors (Di John & Putzel, 2009). The main problem is not an apparently strong state, but rather the challenge to overcome its weakness vis-à-vis elites (Di John, 2006). Hence, the solution to low tax revenues would be to strengthen government autonomy from business elites and to push back against the elites' grip on policy decisions. In the present analysis, I consider that state-society relations per se are neither fully characterised by 'state capture' nor by 'government autonomy' (Timmons, 2005), but rather by constant bargaining about the amount of autonomy and the form and levels of control by interest groups.

Assuming state capture, key social groups use the state to increase benefits for themselves. "Groups or classes influence politicians through lobbying, campaign contributions, and other political activities, including the threat of force. Policy outcomes reflect their relative power" (Timmons, 2005, p. 534). Institutions result from the power struggles between opposing interests.

Democratic institutions are often seen as an institutional setting that leads to redistributive taxation. Democracies are thus expected to redistribute wealth more actively (Acemoglu, 2007) as the median voter is expected to be in control of policy decisions (Besley & Persson, 2014). Therefore, countries with greater inequality as defined by the distance of the median to the mean income are expected to tax more (Besley & Person, 2014). The main idea of the democracy and redistribution literature is that the stronger the pressure "of the general population on the economically and politically powerful actors, the higher the tax contributions of the latter will be" (von Schiller, 2012, p. 8). Yet, the expectations of the median voter theorem do not hold for Latin America. Today, the region is among the most democratic in the world. However, despite recent advances, it remains the most unequal region in the world (Wehr, 2011).<sup>9</sup> A possible explanation for part of this apparent contradiction is legislative malapportionment to the benefit of elite sectors (Ardanaz & Scartascini, 2013).

The democracy and redistribution argument focuses exclusively on the "pressure from the general population on elites, who are understood as a unitary actor unequivocally opposed to taxation" (von Schiller, 2012, p. 8). However, elites might also have a positive motivation to pay taxes since the state guarantees property rights, security and provides infrastructure

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9 In the Ecuadorian case, the return to democracy was even accompanied by an increase in inequality during the 1980s and 1990s (Wolff, 2008).

(Fairfield, 2013; Timmons, 2005). It also assumes that popular discontent with inequality will translate into pressure on elites and thus translate into higher taxes. Yet, neo-liberal policies have often structurally undermined the power resources and the ability of popular sectors to organise (Wolff, 2008).

Furthermore, the weakening of state capacity can set in motion a ‘vicious cycle’ of low public revenues and low state legitimacy. The perception of state failure undermines citizens’ acceptance of taxes. Even though the much higher levels of inequality make Latin American societies more polarised between poor majorities and wealthy elites, this does not translate mechanically into societal organization along this cleavage (Wolff, 2008). The analysis of political settlements that has emerged from historical political economy refers to the “balance or distribution of power between contending social groups and social classes, on which any state is based” (Di John & Putzel, 2009, p. 4). Hence, the analysis must not focus on institutional design, but rather on the underlying political settlement (Di John & Putzel, 2009, p. 6). Elites are not seen as a unitary actor, while focus is put on intra-elite contention and bargaining between different sectors of the elite. Multiple cleavages exist between political and economic, industrial, rural and commercial, rural and urban, central and regional elites (Di John & Putzel, 2009). Contention and bargaining evolve between various elite segments, as well as between elites and non-elites and can occur along lines of ethnic, linguistic or religious division (Di John & Putzel, 2009; see also Lieberman, 2001). Contention and bargaining also evolve between those who occupy the state and those who hold key positions in society more widely (Di John & Putzel, 2009).

I thus analyse changes in the power relations between the state and various different societal groups as well as the latter’s influence on, and presence within, state apparatuses, thereby focusing especially on the power of economic elites. From the structural power perspective, increased revenues from natural resources increase the bargaining power of the incumbent political elite, resulting in less government concessions being made to interest groups. The argument is that increasing resource revenues have enhanced Ecuador’s ability to levy taxes on domestic elites as the available revenues have reduced the structural investment power of the business sector. And, in turn: increased public expenditures have improved citizens’ perception of the state and led to higher public support of the incumbent government (Daude et al., 2012; Moore, 2008). Yet, the structural power perspective does not answer why, in other cases of increasing resource revenues, instead of taking measures to strengthen tax administrations and to increase taxes on economic elites, the opposite has happened. It is thus important to take instrumental power relations and the significance of government agency for tax policy reform into account.

Assuming that the government is interested in taxing economic elites, various strategies are available to it. On the revenue side, business elites might be receptive to horizontal equity appeals and thus accept measures against tax evasion and the closing of loopholes that permit legal tax avoidance. The support of popular sectors can be strengthened by appealing to vertical justice (Fairfield, 2013). Meanwhile, governments can appeal to elites by promising business-friendly expenditures or strengthening legal guarantees and stability; or seek the support of non-elite sectors by linking tax increases to popular benefits (Fairfield, 2013). Which strategy a government will pursue and its success therein depend on the distribution of instrumental and structural power within society and on the

availability of revenues, which can be used for credible commitments to government expenditures as a tool to overcome opposition to tax policy reforms.

### **3 Data and conceptual approach**

In the following subsections, I intend to outline the methods and analytical tools that I have applied in order to grasp the process of change in Ecuador's fiscal policy arena.<sup>10</sup>

First, I will summarise the data sources that I have used in my analysis before pointing out the way in which I have traced changes in Ecuador's fiscal policies between 2007 and 2013, a process I refer to as the 'virtuous cycle'. This process of change cannot be comprehended by looking at government and legislative decisions alone. For this reason, I discuss the various stages of policymaking, tracing the process of change in Ecuador's fiscal policies within the context of the Citizens' Revolution (Subsection 3.2). These stages include agenda-setting, policy formulation, decision-making, and policy evolution; each of them is more or less strongly associated with specific types of instrumental power.

#### **3.1 Data sources**

In my analysis, I take quantifiable factors into account, such as the level of direct and indirect taxes. I include statistics on public investment, current spending, and the evolution of public deficit. I also analyse survey data on citizens' opinions on taxation; perceptions of state legitimacy; and the quality of public services. I do so, as quantitative studies show the relation of these factors to the level of tax revenues (Daude et al., 2012; Luttmer & Singhal, 2014). In addition to polling data that is representative of the general population (mainly Corporación Latinobarómetro, 1995-2015), I also capture the perception of economic elites by relying on data from the WEF's Executive Opinion Survey. Most direct taxes are paid by corporations and there is a pronounced intersection of the owners and the management level of Ecuadorian economic elites.

Furthermore, apart from socio-economic factors and individual perceptions, the political-institutional setting and the channels of organised interest groups' power resources and interaction with government authorities play a major role. This depends on the ability of interest groups to put their concerns on the agenda and the formal and informal channels available to them, on the government's ideological orientation and the degree of consensus among policymakers, but also on public opinion and the government's perception of vulnerability to social protests (McGuire & Scherrer, 2010; Meyer, 2004). The case study approach is suitable in order to take a deeper look at the process of political bargaining. Here, semi-structured interviews with experts and stakeholders have been a source of valuable background information.<sup>11</sup>

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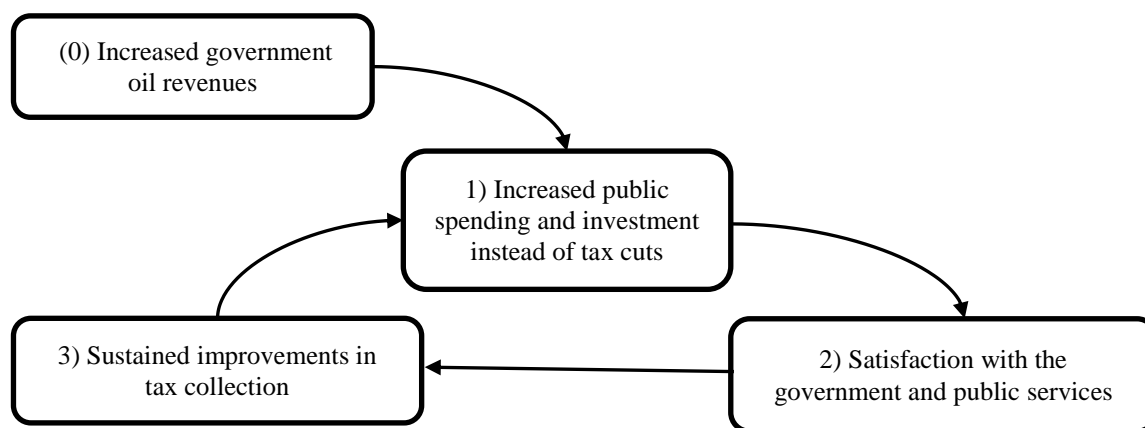
10 My main focus is on taxation; however tax policy outcomes cannot be discussed in isolation: the role of alternative revenues such as resource revenues as well as the expenditure sites must also be taken into account.

11 I conducted semi-structured expert and stakeholder interviews from October 2014 to March 2015 and additional interviews in June 2016. A list of interviews can be found in the Appendix.

### 3.2 Tracing the ‘virtuous cycle’

As pointed out above, I take the negative correlation of high resource revenues and efforts in domestic taxation that are assumed in rentier state theory as a starting point for my analysis. The case study framework allows me to take into account different stages of the political process since the start of the Citizens’ Revolution and reflect on the similarities and differences to prior initiatives aimed at increasing tax revenues.

**Figure 1: The ‘virtuous cycle’**



Source: Author

The ‘virtuous cycle’ model assumes that, in the Ecuadorian case discussed here, an increase in resource rents has triggered positive developments in Ecuador’s tax policies. I take this model as a starting point, as it enables me to look at the explanatory strength of the various different theoretical approaches taking into account different sequences of the process of change since 2007. Thus, beyond the correlation of factors, assumptions about the direction of causalities can be either confirmed or rejected. In order to trace the ‘virtuous cycle’, I analyse the available statistical data with regard to fiscal indicators as well as polling data on public opinion. In the analysis, I take into account that policymaking consists of different stages, including agenda-setting, policy formulation, decision-making, policy implementation, and policy evaluation (Jann & Wegrich, 2007).

‘Agenda-setting’ develops, as interest groups try to put their requests on the government’s agenda and legislative agenda, while governments seek support – or at least passive acceptance – for their initiatives among stakeholders. Although this may occur in the public sphere, it may also be based on non-transparent lobbying channels; and it may be focused on specific taxes or relate to broader discontent and a demand for lower taxes. ‘Policy formulation’ and ‘decision-making’ describes the process extending from the acknowledgement of a problem to the formulation of a policy response that is approved by the authorities. The ‘implementation of policies’ is the duty of state bureaucracies. In most cases, however, effectiveness cannot be assured by a coercive top-down process alone, but depends on interaction with civil society and citizens. With regard to taxation, the need for voluntary cooperation is especially highlighted in fiscal sociology approaches (Burghardt, 1979; Moore, 2004).

Finally, public policies are continuously ‘evaluated’ in different ways. The evaluation process includes established mechanisms within the state apparatus, but also among

academia, media reporting and organised interest groups. This process is also an important stage for setting the future policy agenda. The policy cycle is often applied to the in-depth analysis of specific reform processes (Jann & Wegrich, 2007). However, in the present context, it represents a framework through which to grasp the origins of change in policy outcomes over a period in the medium term.

## **4 Fiscal policies and revenues in Ecuador: an empirical overview**

From 2007 to 2013, Ecuador witnessed an important increase in public revenues. The goal of the present section is to put this revenue increase into perspective and to provide empirical information about the various factors that have contributed to the increase. Revenues of the non-financial public sector lay at 24.1 per cent of GDP in 2006. This level increased to 39.4 per cent in 2013 (Banco Central del Ecuador [BCE], 2014). Public spending increased from 21.1 to 44 per cent during this period. The increase took place while the average growth rate of GDP was 4.2 per cent between 2007 and 2013 (Secretaría Nacional de Planificación y Desarrollo [SENPLADES], 2014). There has been an important real increase in public expenditures. Nonetheless, it is important to recognise that government sources estimate that 9.2 per cent of the increase in current expenditures is the result of making all revenues and expenditures transparent (Ministerio de Trabajo [MITRAB], 2015).

I start by discussing the recent past of Ecuador's fiscal policies from the so-called 'boom petrolero' that created Ecuador's oil-dependent economic structure, to the turbulent decade that preceded the Citizens' Revolution. What follows is an analysis of legal changes. Here, I look at constitutional rules and objectives with respect to fiscal policy and then sum up key changes in tax legislation. The summary starts with revenue changes as of 2007 and examines resource revenues. Thereafter, I turn to the evolution of non-resource revenues. My main focus will be on taxes. Finally, the evolution of public debt will be discussed.

### **4.1 Ecuador's fiscal policies: the recent past**

In order to evaluate recent dynamics in Ecuador's fiscal policies, a short review of its recent history is crucial. My considerations on tax policies are discussed, embedded in the evolution of the political-economic development path. I briefly touch on the 'boom petrolero' during the latest military rule (1972-1979) and the neoliberal adjustment policies of the 1980s, before focusing on the developments immediately preceding the Citizens' Revolution.

The latest period of military rule started a month before the 'boom petrolero'. Under the rule of Rodríguez Lara (1972-1976), the government did not strengthen the country's fiscal system in light of available resource rents. Instead oil revenues were in part used to give tax incentives to private business (Dunning, 2008). At the political level, even though the military government was of reformist orientation and more autonomous from business elites than previous civilian administrations had been, it also seized power in order to prevent a possible presidency of Guayaquil's populist mayor Assad Bucaram whose

promise of redistributive policies was feared by the country's economic elites (Dunning, 2008; Isaacs, 1993).

In 1976, the self-proclaimed 'revolutionary and nationalist' military-government was replaced by an even more business-friendly military 'triumvirate' (1976-1979). When oil-revenues started to decline, the military government used foreign loans to finance its development objectives instead of increasing domestic revenues (Bocco, 1987; Paz y Miño, 2006; Carvajal, 2011). The consecutive military governments were successful in promoting fast-track industrial development and increasing industrial exports. Yet, imports increased more rapidly as this created a subsidised and import-dependent industrial sector (Correa, 2014). Ecuador returned to democracy in 1979. Jaime Roldós' election represented a victory for left-leaning populism. Oil revenues allowed the government to finance social programmes without increasing taxes on the wealthy (Dunning, 2008).

After Roldós died in an aeroplane accident, gradual steps towards market liberalization and austerity were taken during the Hurtado presidency (1981-1984) as Ecuador found itself in the midst of the Latin American debt crisis. The crisis had been caused by previous over-borrowing, the irresponsible use of resources and reduced oil revenues, but also by high interest rates due to the massive rise in interest rates initiated by Federal Reserve System (FED) chairman Paul Volcker (Paz y Miño Cepeda, 2015). The model was fully implemented during the right-wing government of the Partido Social Cristiano (PSC) politician and Guayaquil business leader Febrés Cordero (1984-1988). This would be better described as a business-led strategy than as textbook neo-liberalism<sup>12</sup> and expresses an increasing instrumental power of Guayaquil elites that are more related to foreign trade and less dependent on protectionism.

The end of the oil-boom and the fiscal crisis of the 1980s coincided with a wave of neoliberal anti-statism at the international and national level. The dismantling of the developmental state and austerity were top of the agenda of the international financial institutions.

The crisis of the 1980s did not lead to successful attempts to increase the tax-to-GDP ratio but rather to spending cuts. Time and again, business associations and right-wing politicians pushed for an abolishment of the income tax (Paz y Miño Cepeda, 2015). Nonetheless, some major tax reforms are worth noting: a consumption tax was introduced in 1982 and increased from 5 to 6 per cent in 1983 and to 10 per cent in 1986. In 1989, exceptions to this tax were eliminated and the tax was now collected as VAT (Chiliquinga Carvajal, Carrasco Vicuña & Ramírez Álvarez, 2012). The 1989 reform created the basic structure of Ecuador's tax system, which included personal and corporate income taxes, VAT and taxes on special consumption (Paz y Miño Cepeda, 2015). The reforms must be seen in the context of decreasing tariff revenues due to trade liberalisation. The strategy to replace this loss in revenues by VAT was thus in line with International Monetary Fund (IMF) approaches of the time that demanded reforms to be neutral in terms of revenues.

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12 For instance, Hurtado's decision to alleviate private corporations by paying their US dollar debt and accepting reimbursement in sucre the so-called 'Sucretización', exemplifies the political influence of business in the 1980s. In the context of currency devaluation, the decision shifted a large part of the debt-burden from the private to the public sector. The Cordero government made the conditions even more beneficial to the corporations involved (Paz y Miño Cepeda, 2015).



At the political level, all five elected governments in the period from 1979 to 1996 managed to complete their term.<sup>13</sup> However, at that time, conditions of institutional gridlock were already present.<sup>14</sup>

The crisis in the political system began with the election of neoliberal populist Partido Roldósista Ecuatoriano (PRE) politician Abdalá Bucarám in 1996 and his ousting after only six months in office. From 1996 to 2006, none of the three elected presidents – Abdalá Bucarám, Jamil Mahuad and Lucio Gutiérrez – finished their terms in office. A lack of legislative support for the government, ad-hoc alliances in Congress, the use of street mobilisation to forward clientelist agendas, and the regionalism of Costa and Sierra watered down any reform proposals. Grass-roots organizations – and especially the indigenous movement – put increasing pressure on the already fragile system (Minkner-Bünjer, 1999). For most of the 1990s, the tax-to-GDP ratio remained at an extremely low rate, but increased substantially between 1998 (6.2 per cent) and 2001 (11 per cent).

This development was brought about by different factors: The Mahuad government (1998–2000) was in desperate need of revenues as the economic situation had worsened. The deep financial and economic crisis of 1999 and 2000 could not be prevented. Public debt increased from 55.9 per cent in 1998 to 85.5 per cent in 1999. The country partially defaulted in 1999 and debt restructuring led to the reduced debt level of 76.7 per cent in 2000<sup>15</sup> (Ministerio de Finanzas [MINFIN], 2013; IMF, 2002). After complex coalition-building and bargaining, revenue-increasing reforms passed Congress in November 1999. VAT was raised from 10 to 12 per cent<sup>16</sup>, income taxes were augmented, and the tax on capital circulation was reduced<sup>17</sup> (Minkner-Bünjer, 1999).

Almost simultaneously, the Servicio de Rentas Internas (SRI) was established as a semi-autonomous revenue agency for tax collection.<sup>18</sup> The transition lasted from December 1997 to March 1999 and included an almost complete change of personnel (Romo-Leroux Chávez de Mena, 2000).<sup>19</sup> The creation of the SRI is often regarded as a major success and important precondition for later achievements (Mejía et al., 2008). Here, one must not forget that it was established in order to shield the revenue collection from political interference and the widespread corruption generally ascribed to the public sector at the time. The business-led neoliberalism did reduce public expenditures, but failed to provide a pathway towards a coherent state and an efficient use of public funds. As in other Latin

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13 Jaime Roldos, who died in an accident in 1981, was succeeded by Oswaldo Hurtado Larrea (1979–1981/1981–1984), Leon Febres Cordero (1984–1988), Rodrigo Borja (1988–1992) and Sixto Durán Ballén (1992–1996).

14 Between 1979 and 2006, the governing party did not have a parliamentary majority. While the parties had national reach in theory and used to present nationwide candidates, their electoral base and the interest groups they represented tended to be concentrated in either the Costa or Sierra region.

15 The reduction of domestic debt in net present values was 9 per cent and that of foreign debt 41 per cent; however these benefits were partly offset by higher interest rates on new debt (IMF, 2002).

16 The initial proposal by Guillermo Lasso entailing an increase to 15 per cent was blocked by Congress.

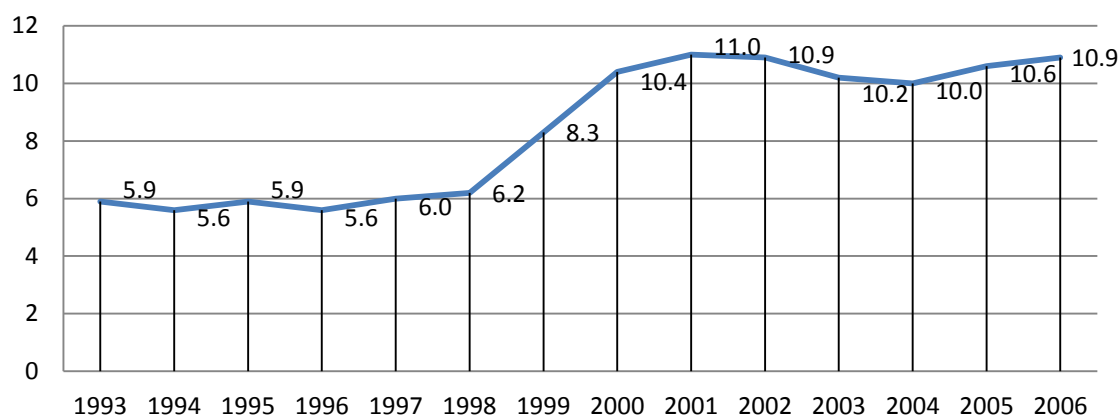
17 The promise to improve tax collection was made to the IMF in October 1999 (Lucas, 1999).

18 The reform process was supported by the Inter-American Development Bank (Arraiz, 2008).

19 A broad consensus exists in Ecuador that the establishment of the semi-autonomous revenue agency Servicio de Rentas Internas (SRI) and the work of its director Elsa de Mena (1998–2004) was a major step forward in Ecuador's tax administration. Interviewees from various different strands of society highlight the contrast to the spurned Dirección General de Rentas (DGR).

American countries, rather than overcoming corporatism, new forms of fragmented corporatism gained importance in the era of adjustment policies (Boris, Gerstenlauer, Jenss, Schank & Schulten, 2008; Quintero & Sylva Charvet, 2010).

**Figure 2: Tax-to-GDP ratio in Ecuador 1993-2006, in per cent**



Source: Servicio de Rentas Internas [SRI] (2007)

SRI-director, Elsa de Mena, remained in office under three different presidents, which not only indicates an at least partially successful isolation of the revenue authority from the pressures of economic interest groups and party-political power struggles but also a surprising continuity in times of political turmoil (Mejía Acosta, Caridad Araujo, Pérez-Liñán & Saiegh, 2008). However, de Mena was then dismissed by Lucio Gutiérrez in 2004 who sought a parliamentary alliance with the business magnate and political leader Alvaro Noboa, whose corporations were under SRI scrutiny at the time (Mejía Acosta et al., 2008).<sup>20</sup>

Most of the increase in the tax-to-GDP ratio took place between 1998 and 2001. VAT evasion was successfully reduced between 1999 and 2002, though the evasion rate increased markedly thereafter but without returning to pre-1999 levels (Arraiz, 2008). The estimated rate of income tax evasion lay at 63.8 per cent in 2005 (Gomez Sabaini & Jiménez, 2012). The overall tax-to-GDP ratio in 2006 remained at the 2001-level. This alarming level of tax evasion indicates that important problems remained unresolved. The prospects for further positive changes in Ecuador's tax policy outcome were hampered for the following reasons.

- A return of party politics to decisions about tax administration.
- A preference for low taxes, even at the expense of social services.<sup>21</sup>
- Low levels of confidence that taxes were being collected impartially.<sup>22</sup>

20 Alvaro Noboa is commonly referred to as Ecuador's richest person. He has been candidate for president on five separate occasions and reached the run-off in 1998, 2002 and 2006. In 2013, his largest plantation was seized by the SRI, based on allegations of unpaid tax obligations.

21 In a 2002 Latinobarómetro poll, 61 per cent of respondents 'agreed' or 'strongly agreed' that taxes should be as low as possible, even if that would lead to less social spending (Corporación Latinobarómetro, 1995-2015).

22 The preference for lower taxes coincided with only 6.7 per cent of respondents in 2003 and 11.5 per cent of respondents in 2005 who had confidence that the state would make good use of taxes. Meanwhile, a large and consistent majority viewed the taxes as either 'high' or 'very high'.

- Low levels of confidence that the state would make good use of tax revenues.
- Institutional gridlock due to a lack of parliamentary support for the president, combined with low government approval ratings.

<b>Table 1: Approval of incumbent government that is led by the President</b>					
	2002	2003	2004	2005	2006
Disapprove	64%	69%	78%	67%	72%
Approve	30%	27%	20%	24%	22%
Not sure/no answer	6%	5%	3%	9%	5%
Source: Corporación Latinobarómetro (1995-2015)					

## 4.2 New constitutional objectives and changes in tax legislation

The new 2008 Constitution had no direct effects on tax levels. However it can be seen as an important guide to the main principles and aims of Ecuador's tax and fiscal policies. It clearly stated that the tax system should be progressive and that taxation should serve the goals of equality and redistribution (Jiménez, 2015). The new constitution also guided the goals that were later established in national development plans with regard to a focus on direct taxes. The 2008 Constitution established the fact that permanent expenditures must be financed with permanent revenues, and thus for the most part by taxes (Constitución del Ecuador, 2008, Article 286).

The SRI itself estimates that 91.4 per cent of tax increases are due to improvements in the tax administration ("Directora de SRI anunció que recaudación tributaria de 2015 sería de 14.099 millones de dólares", 2014, 14 November). Income tax evasion decreased from 61.3 per cent in 2006 to 30 per cent in 2013, while the evasion of VAT was decreased from 40 to 20 per cent over the same period ("SRI anuncia recaudación tributaria de \$ 12.800 millones en 2013", 2013, 9 December). Despite that, I will now summarise legal changes in Ecuador's fiscal policies from 2007 to 2013. Hereby, I intend to put the main focus on tax legislation. With regard to tax evasion and tax elusion, regulatory reforms have been important to strengthen the tools available to tax administration (Castro, Aguilar & Sáenz, 2013). Furthermore, the legislative process is important as conflicts over tax rates at this level are more public than changes at the administrative level. Overall the legislative branch did not undermine the efforts made by the Correa administration to increase tax revenues. There are two key reasons for this: one is the parliamentary strength of Alianza PAIS and allied parties as well as high levels of government approval ratings; the other is that the 2008 Constitution had provided the executive branch with stronger faculties in the fiscal policy arena (Constitución del Ecuador, 2008).

I now turn to a summary of legal changes in Ecuador's tax code. The 2007 law on tax equity represented a milestone in Ecuador's tax policies. Despite some new tax exemptions, it had a positive effect on government revenues (Carpio Rivera & Carrasco Vicuña, 2012). The most visible change was the introduction of new top rates of 30 and 35 per cent to the personal income tax. On the other hand, personal spending, mainly on education and healthcare, were made deductible (Castro, Aguilar & Sáenz, 2013). The tax

rate for firms remained at 25 per cent.<sup>23</sup> New incentives were created in order to promote social inclusion and employment creation, especially for disabled persons. The tax on inheritances and donations was changed from a flat tax of 5 per cent to a progressive scheme with a maximum marginal rate of 35 per cent. A tax on rural land was introduced to promote a more just distribution (Carpio Rivera & Carrasco Vicuña, 2012; Chiliquinga Carvajal et al. 2012). More importantly, a tax on capital outflows was created. Carpio Rivera and Carrasco Vicuña (2012) point out the progressive impact of the tax and that its main purpose was to strengthen macroeconomic stability within the context of dollarization. A windfall tax was created in 2007 that had an effect on the oil sector (Carpio Rivera & Carrasco Vicuña, 2012). However, it was only of major importance in 2009 when it accounted for 6.7 per cent of all tax revenues. In 2010, the oil contracts changed to service contracts so that corporations did not dominate the oil sector anymore and did not benefit from price increases directly (Castro et al., 2013). Concerning indirect taxes, changes were made with regard to the categorization of products. Special consumption taxes were rationalised by focusing taxation on luxury goods and by taking into account externalities concerning the environment, health and social impacts (Carpio Rivera & Carrasco Vicuña, 2012).

The 2007 reform strengthened administrative processes and enforcement mechanisms. A minimum advance payment for income tax was established. Higher interest rates for delayed tax payments along with higher sanctions for regulatory offences and violation were introduced. Furthermore, regulations related to transfer pricing while international taxation were included in the national tax code. Carpio Rivera and Carrasco Vicuña emphasise that fourteen prior reforms had not focused on so-called tax planning schemes, which they portrayed as evasion mechanisms that included the use of tax havens. However, changes introduced in 2008 had a negative impact on revenues as they provided additional tax breaks for various economic sectors.

In 2009, a reform came into force that increased the tax on capital outflows from 0.5 to 1 per cent and cancelled exemptions. Furthermore, a tax on assets held abroad was created with minor effects on revenue. The main objective was to favour the productive sector by way of credit-related reforms through the reinvestment of financial institutions and rebates in advance income tax payments (Carpio Rivera & Carrasco Vicuña 2012, p. 301). Also in 2009, a law was passed to amend the internal tax regime and the tax equity law. The tax on capital outflows was increased from 1 to 2 per cent. The tax exemption for dividends received by residents in Ecuador was removed. Furthermore, various VAT exemptions were eliminated. Overall, the effect on tax revenues was positive, especially when it came to direct taxes.

The 2010 code of production, trade and investment represented a major change in the tax code. Its main objective was to incentivise private investments. No revenue-increasing measures were taken, while new exemption mechanisms and possibilities for deduction were created. The most notable change was the reduction of corporate income taxes from 25 to 22 per cent over a three-year period (Castro et al., 2013). The law amplified incentives for special economic zones such as tariff exemptions.

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23 Employees receive 15 per cent of corporate profits, except for those working in the telecommunications and petroleum sectors.

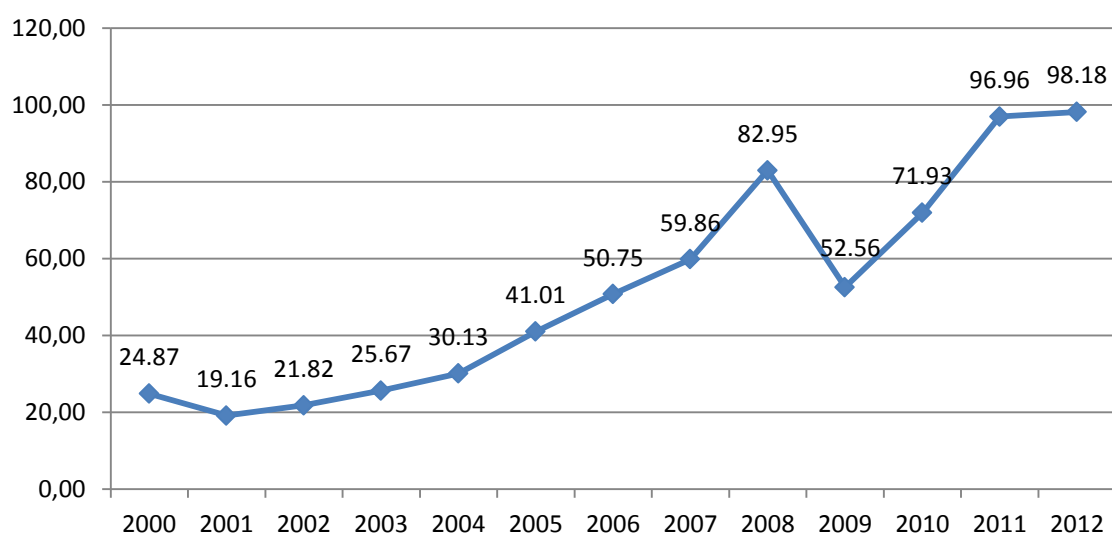
In 2011, a law for environmental development and optimization of state revenues<sup>24</sup> was passed. It had a net positive effect on tax revenues due to stricter regulations on existing taxes and the introduction of new ones. The main change was the increase of the tax on capital outflows from 2 to 5 per cent. Finally, in December 2012, the *Law of Income Redistribution for Social Spending* was passed. A 10 percentage point reduction of the corporate income taxes for banks was eliminated and advanced tax payments by banks and other financial sector corporations were increased. The VAT tax of 12 per cent was applied to financial services. The tax on assets held abroad was changed to a monthly rate of 0.25 per cent and of 0.35 per cent for assets in tax havens.

<b>Table 2: Types of changes simulated for each type of tax</b>	
<b>Tax</b>	<b>Type of change</b>
Income tax (natural persons)	Yes in the payment structure and tax rate
Income tax (companies)	Only in regulations that affect tax declarations and generate changes in the conduct concerning compliance and evasion.
Tax on windfall revenues, effective in the oil sector	New tax
Tax on cars	No effect of changes
Tax on capital outflows	New tax
Assets abroad	New tax
Simplified taxation system (RISE)	New tax
Mining royalties and patents conservation	New tax
Rural land	New tax
VAT	Changes in the structure of taxable goods
Special consumption tax (ICE)	Changes in the structure of goods that are taxed with the special consumption rate
Source: Castro et al. (2013)	

### 4.3 Resource rents and the increase in fiscal space

At the beginning of its first term in office, the Correa administration benefited from increased oil revenues. The nominal price for a barrel of Ecuadorian oil had an upward tendency from 2001 onwards. While the price was less than USD 20 in 2001, it lay above USD 50 on average in 2006. From 2007 to 2008, the price jumped from USD 59.86 to 82.95 on average (Ministerio Coordinador de la Política Económica [MCPE], 2013). In 2012, the average price for Ecuadorian oil reached USD 98.18. However, the volatility of the oil price was also a factor: the oil-price plummeted to an average of less than USD 53 in 2009.

24 A new special tax regime for the banana sector was created. Various taxes were introduced for environmental reasons, such as a new tax on vehicle pollution and a deposit system for plastic bottles.

**Figure 3: Average nominal price of Ecuadorian oil, in USD**

Source: MCPE (2013)

The nominal price is only a rough indicator for the level of public-sector oil revenues. Ecuador's oil revenues are composed of the export of crude oil and exports and domestic commercialization of derivatives. Total export income increased 72% between 2006 and 2010. In 2010, it reached USD 7.442 billion. This increase was to a large part caused by higher prices (Cueva & Ortiz 2013, p. 32). The revenue from the domestic commercialization of derivatives increased from USD 878 million to 1.569 billion in 2010 (Cueva & Ortiz 2013, p. 33). Oil-revenues as a percentage of total central government revenues increased from 20.8 in 2007 to 33.5 per cent in 2008 and peaked again in 2011 (34.7 per cent), but were reduced to 23 per cent in 2013 (MINFIN, 2014).

One must not forget that resource funds and other pre-allocations of resource revenues were eliminated in 2008 by the Organic Law on Petroleum Resources Recovery.<sup>25</sup> The oil funds were transferred to the general budget, which led to a positive shock for the central government (Cueva & Ortiz 2013, p. 35). This legal change had an important effect in making the revenues visible and available for the government. Savings that were put in resource funds before were now made use of for domestic investments.<sup>26</sup> In addition to that, Ecuador decided to renegotiate oil contracts with private corporations in 2010 and replaced profit-sharing agreements with flat-fee service contracts. According to government sources, this renegotiation has benefited Ecuador's public finances with USD 2.795 billion of additional revenue by the end of 2012 (Ministerio de Recursos Naturales No Renovables [MRNNR], 2013). Oil extraction increased from 177,071.9 thousand barrels in 2010 to 206,970.8 thousand barrels in 2014. The renegotiation did not cause a general decrease in oil extraction (BCE, 2015). The public sector continuously increased its share of total oil extraction from 37 per cent in 2004 to 62 per cent in 2010 and 76 per cent in 2014.

In sum, despite the crisis of 2009, oil revenues were at relatively high average levels during the period 2007 to 2013, when compared to the available resource income in the

25 Ley Orgánica para la Recuperación del uso de los Recursos Petroleros del Estado y Racionalización administrativa de los Procesos de Endeudamiento.

26 I discuss the long-term effects of this decision in Subsection 4.5.

period immediately preceding. This is not to say that Ecuador's oil revenues were at a level comparable to the 'boom petrolero' of the 1970s. Adjusting for inflation and taking into account the quantity of extraction, the extraction costs as well as population growth, per-capita oil revenues were not particularly high in the period 2007 to 2014. The government estimates that they were in fact lower than the average between 1972 and 2006, yet higher than during the turbulent decade that preceded the Citizens' Revolution ("Ingreso petrolero promedio per cápita entre el 2007 al 2014 ha sido menor que el valor histórico", 2015, 14 March).

#### 4.4 Non-resource based revenues and the relevance of taxation

Apart from the taxes raised by the SRI, fiscal revenues include social security contributions<sup>27</sup>, tariffs and revenues raised at the municipality level. These revenues increased from 15.5 per cent in 2006 to 20.8 per cent of GDP in 2013 (Amoroso & Oliva, 2015). Non-resource based revenues also include positive transfers from public enterprises outside the sector of non-renewable resources. These transfers have grown in importance in recent years (BCE, 2014). Measured against GDP, central government tax and tariff revenues increased from 11.6 per cent in 2006 to 15.1 per cent in 2013. This increase was due to domestic revenues which increased from 10 to 13.5 per cent (Amoroso & Oliva, 2015).<sup>28</sup> Ecuador collected USD 21.995 billion of taxes between 2000 and 2006 and USD 60.660 billion between 2007 and 2013 (SENPLADES, 2014).

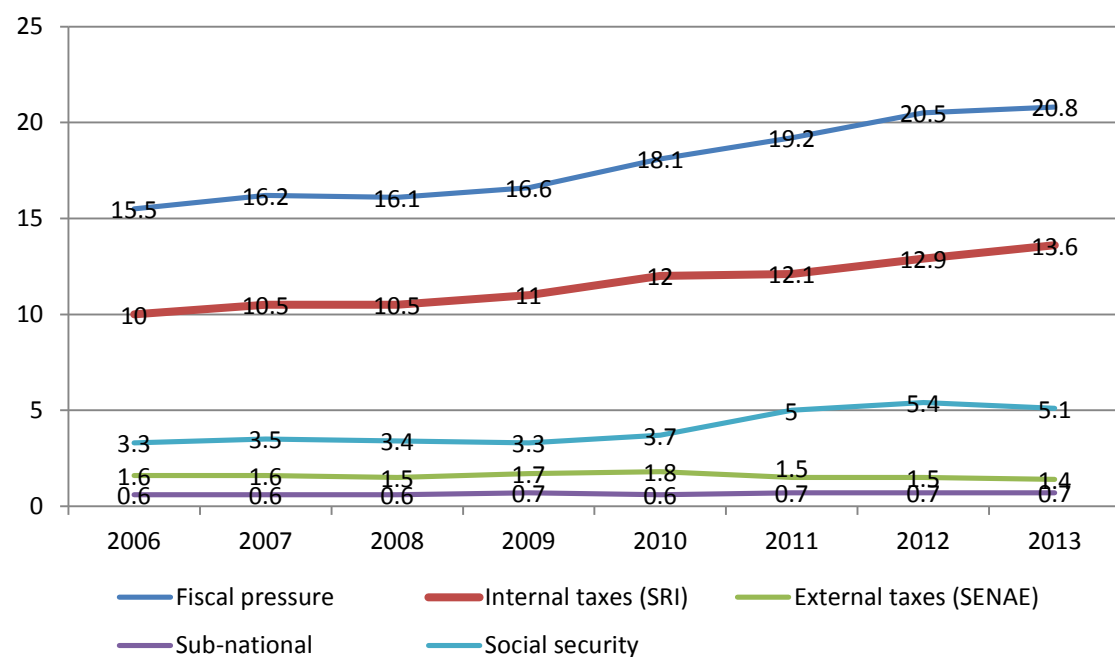
It is also important to analyse changes in the composition of taxes. In general terms, the data suggests that the tax system has become less regressive. According to SRI reports, direct taxes represented only 33 per cent of tax revenues in 2006, while this share reached 46 per cent in 2014<sup>29</sup> (SRI, 2007; SRI, 2015). However, direct taxes are still mainly paid by the corporate sector. Personal income tax and wealth taxes play a minor role. This is due to a combination of a highly unequal primary income distribution and the relatively high level of tax-free income that is allowed, especially when tax deductions are taken into account. This leads to a small tax base for personal income tax (Ramírez Álvarez, Carrasco Vicuña & Arias Urvina, 2012). Jiménez (2015) points out that 83.7 per cent of income earners did not reach the threshold for the personal income tax; in 2013, the 35 per cent top rate only affected 0.19 per cent. Consumption taxes still play the main role in Ecuador's tax revenues, with VAT being the most important tax. Its regressive nature is reduced by the exclusion of most of the basic food basket (Redacción Economía, 2015, 28 January).

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27 Social security contributions increased from 3.5 per cent of GDP in 2006 to 5.1 per cent of GDP in 2013 (Amoroso & Oliva, 2015). Formal employment increased from 26 per cent in 2007 to 44 per cent in 2014 (SENPLADES, 2015).

28 In this period, revenues from taxes on external trade remained constant, slightly increasing up to 2010 before descending to below 2006 levels in 2013 and 2014. Sub-national taxes played a minor role with levels of between 0.6 and 0.7 per cent.

29 The tax on the outflow of currency (Impuesto a la Salida de Divisas) is labelled a direct tax because of its progressive characteristics.

**Figure 4: Evolution of non-resource based fiscal revenues to GDP, in per cent**

Source: SRI (2015); Amoroso &amp; Oliva (2015)

#### 4.5 The evolution of public debt and sustainability concerns

In a simplified model, public debt can be seen as an alternative to raising domestic revenues: In this case, high public deficits are a sign of a lack in ability to pursue the government's political goals without transferring costs to the future. In the end, the ability to receive loans is limited by the perceived ability to raise revenues (Fjeldstad & Moore, 2008). However, the same logic of transferring costs to the future can be established for a neglect of necessary investments or social spending. Debt sustainability depends on its composition and various factors such as future economic growth and the ratio of debt to sustainable revenues (Flassbeck & Panizza, 2008). The fiscal sustainability of debt depends on a country's ability to collect revenues in order to cover current expenditures. Meanwhile, the external sustainability becomes an issue when debt is in foreign currency (Flassbeck & Panizza, 2008.).

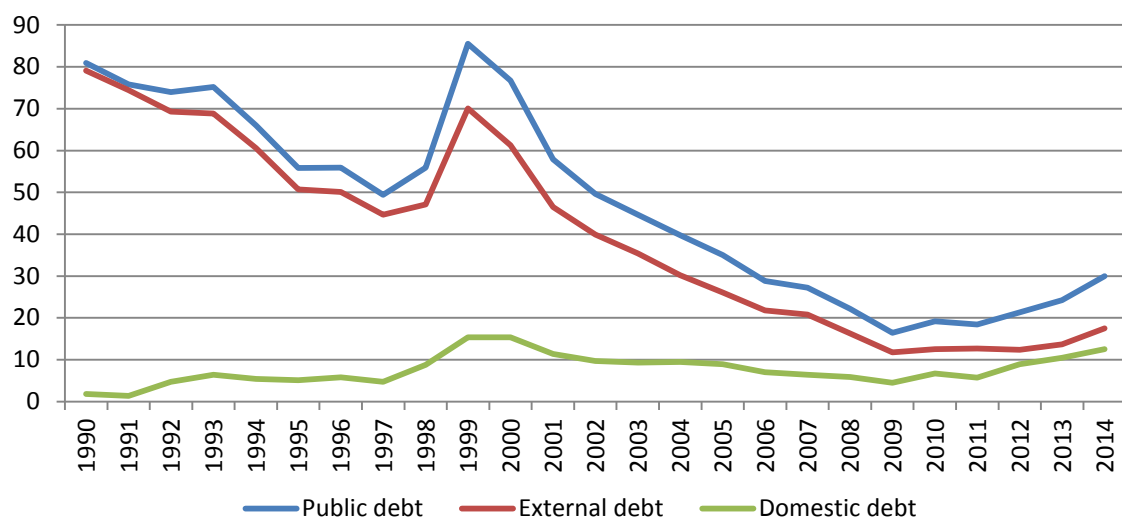
After the financial and economic crisis of 1999-2000, Ecuador followed a strategy of fiscal discipline and tax increases, thereby focusing on regressive consumption taxes. The debt-to-GDP ratio was reduced continuously and reached 28.8 per cent in 2006 (MINFIN, 2015). Already prior to the start of the Citizens' Revolution, Ecuador's improved financial situation had led to a debate about the possibility of buying back foreign debt (Acosta, 2006). Part of the further reduction of public debt in the first years of Correa's presidency, was due to the decision to declare part of the country's debt illegal in 2008. This decision was based on a report from an government-authorized international Public Credit Audit Commission that was supposed to determine the legitimacy, legality, transparency, quality, efficacy and efficiency of Ecuador's debt (Weisbrot & Sandoval, 2009).



On November 20, 2008, the Commission issued its report, finding a number of irregularities and illegalities in the contracting of various portions of the country's public debt. On the basis of the commission's findings, the Correa administration stopped payment on \$510 million of its Global 2012 bonds in December 2008, and then on \$2.7 billion of Global 2030 bonds in February 2009, for a total default of \$3.2 billion. This month, Ecuador completed a buyback of 91 per cent of the defaulted bonds, at about 35 cents on the dollar. The government thus retired about a third of its foreign debt, at a huge discount, in the process reducing its foreign public debt to 17 per cent of GDP. (Weisbrot & Sandoval, 2009)

When the Correa government bought back a large share of Ecuador's bonds, it did so at a close-to-market price rate and thus for much less than the emission price of the respective bonds (Weisbrot & Sandoval, 2009).

**Figure 5: Evolution of public debt in per cent of current GDP**



Source: MINFIN (2015)

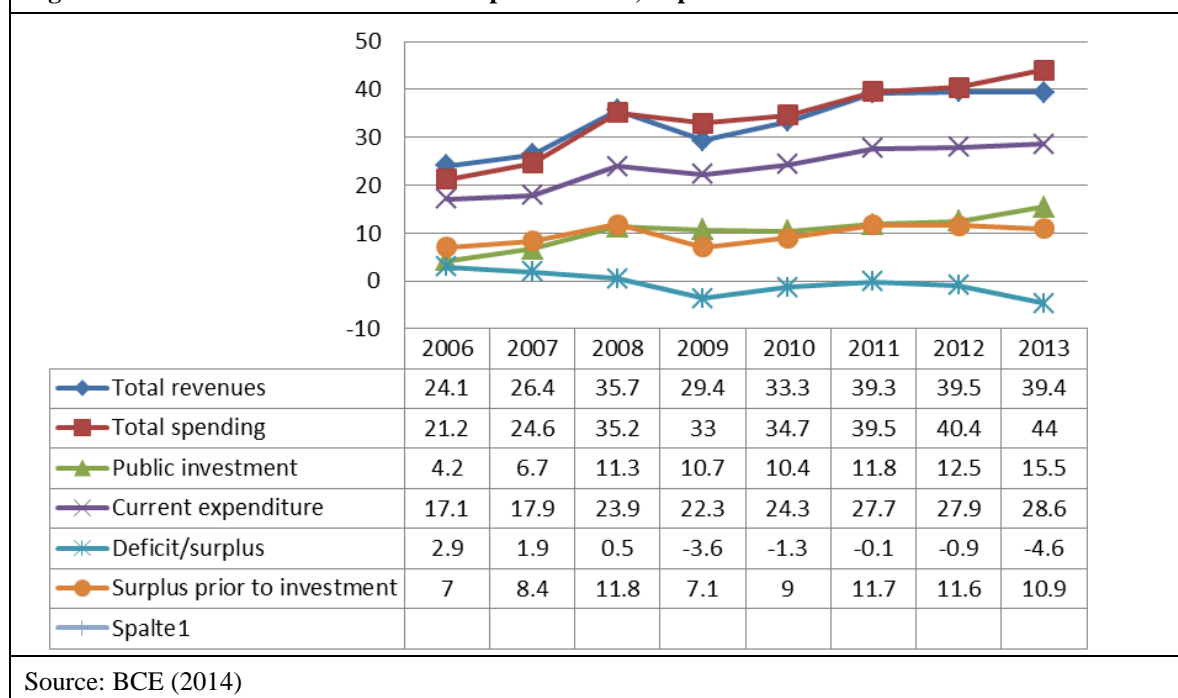
Public debt increased gradually after 2009, reaching a debt-to-GDP ratio of 30 per cent in 2014 (MINFIN, 2015).

At this point, it is appropriate to consider the evolution of public investments. Today's investments lower costs in the future and increase future prosperity. The key to sustainability is to maintain a public sector surplus prior to investments. For this reason, the Latin American Rio group proposed that investment expenditures be excluded from deficit targets. The argument was that current expenditures that were mostly composed of wages and entitlement programmes were more difficult to adjust than investments. However, this ignored the exposure of developing countries to external shocks and volatile GDP growth along with the pro-cyclical effects of adjusting investment spending (Flassbeck & Panizza, 2008). With regard to oil revenues, the abolition of resource funds is to be seen in a similar perspective. This decision did not mean a change from saving to spending, but rather from international financial investments to domestic real investments. An important advantage of this strategy was that domestic investment projects can have much higher returns on investment than resource funds. The main downside is that the resources put in domestic investments are not liquid. There are, though, other more

efficient mechanisms to secure resources in order to respond to emergencies. For instance, Ecuador has contracted standby loans with international financial institutions. This said, to separate oil revenues from the public budget, in order to accumulate it in an investment and stabilization fund, while simultaneously subscribing loans at much higher interest rates as happened in Ecuador prior to the Correa government, appears absurd.

The average budget surplus prior to investments has been much higher since 2007 than in the preceding years. Furthermore, an increasing part of public debt is domestic and to a large extent held by the public social security system, while foreign debt was reduced from 21.8 per cent in 2006 to 17.4 per cent in 2014 (MINFIN, 2015).

**Figure 6: Evolution of the non-financial public sector, in per cent**



## 5 The ‘virtuous cycle’ and its limits

The previous empirical overview provided important quantitative data and legal information for the upcoming analysis. Each of the ensuing subsections refers to a step in what I call the ‘virtuous cycle’. As pointed out previously, the initial idea of the ‘virtuous cycle’ is that increased oil revenues were the starting point for positive developments with regard to the Ecuadorian governments’ willingness and ability to strengthen the country’s taxation system. The various different phases of the cycle overlap and build on each other as changes in tax and resource policies in the first phase led to the revenue increases that allowed for the increase in public investment and improvements in public services that marked the second phase. This has in turn helped to improve citizens’ satisfaction with public services and thus strengthened the state’s ability to raise taxes.

- The first subsection is focused on the dynamics that led to the public sector’s appropriation of increased oil revenues (Subsection 5.1) starting in 2007. This phase was completed with the signing of new oil-extraction contracts in 2010. While resource

revenues increased, so too did domestic fiscal pressure. Important steps on the administrative and legislative level were taken to strengthen tax collection and to make Ecuador's tax system less regressive.

- I then turn to the return of the state regarding public services and investment (Subsection 5.2). Here I also analyse the effects of the new institutional framework set by the 2008 Constitution. Next I consider developments from the 2009 election to Correa's second re-election in 2013 and focus on the expenditure side.
- Finally, the third step of the 'virtuous cycle' refers to the achievement of sustained tax revenue increases (Subsection 5.3). Here, I shall analyse how the investments and expenditures translate into an increased acceptance of taxes. I analyse developments from after Correa's re-election in 2009 and focus on his second re-election in 2013.

I will mention countervailing tendencies that have frustrated attempts at more radical reforms in a separate subsection at the end of this section. In Section 6, I outline fiscal policy challenges after the end of the 'virtuous cycle'.

## 5.1 Appropriation of rent revenues for the public sector

Between 2007 and 2010, the appropriation of increasing resource revenues by the public sector correlates with a more robust approach towards tax evasion and avoidance mechanisms.<sup>30</sup> Increased oil-revenues were appropriated by the state and used for a boost in public investments and not to gain support by either officially decreasing the tax pressure or by reducing collection efforts (Karl, 2007). The political incentive for the Ecuadorian government to do the latter could be considered 'high', given that in 2007 a majority of Ecuadorians perceived taxes as 'high' or 'very high'.<sup>31</sup> The increase in the ratio of fiscal revenues to GDP contradicts what is expected, based on rentier state theory (Fairfield, 2015). This perspective is closely related to fiscal sociology accounts of the historic emergence of modern fiscal states, which see a government's improved ability to collect taxes as the result of the state's necessity to trade revenues for political participation of (some) citizens and liberal control mechanisms in order to obtain revenues (Moore, 2008). This process of bargaining is often regarded as the starting point for the emergence of an implicit fiscal contract. However, the resource revenues make it less likely to enter such bargaining process, as just described, because these revenues tend to be used to replace tax revenues. Thus, the establishment of strong taxation systems is delayed and existing institutions tend to deteriorate (Karl, 2004; Dunning, 2008). Meanwhile, non-tax revenues are seen as a problematic source of government autonomy that leads to an authoritarian state which does not promote broad-based development (Moore 2004, p. 306).

From this perspective, rentier states can escape the fiscal policy dimension of the 'resource curse' when institutional mechanisms are created that effectively shield resource

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30 Ecuador's tax administration was able to announce an important increase in tax collection from large corporations in August 2008 ("SRI: crecimiento de contribución de las grandes empresas del sector privado alcanza el 120%", 2008, 10 August).

31 In 2007, 26 per cent of Ecuadorians regarded taxes as 'very high' and 49 per cent as 'high'. In the 2002 Latinobarómetro poll, a majority of Ecuadorians had expressed their preference for low taxes, even if that would lead to fewer social services; in 2005, only 12 per cent expressed confidence that tax revenues would be well-used by the state in 2005 (Corporación Latinobarómetro, 1995-2015).

revenues from government access, thus obliging the incumbent government to start the process of bargaining with tax payers (as just described) as I pointed out in the first hypothesis. However, the lack of tax revenues can hardly be linked to a lack of participation mechanisms on the part of the economic elites in the Ecuadorian case prior to the Citizens' Revolution. Quite the opposite: the decades after the return to democracy in 1979 are labelled as business-led neoliberalism (Paz y Miño Cepeda, 2014).

Furthermore, rather than taking measures in order to shield resource revenues from government access (for instance by establishing stabilization and investment funds), such funds were abolished by the Citizens' Revolution. The funds were made available for the Correa government and earmarked for investment spending. I therefore argue that perspectives that focus on an increased government autonomy from economic elites (see Subsection 2.3) are best suited to explain this first phase of the 'virtuous cycle'. In this regard, I distinguish between changes in structural and instrumental power relations. The 'virtuous cycle' model highlights the importance of increased resource revenues for positive developments in the fiscal policy arena, especially in relation to the government's ability to tax economic elites. In this scenario, the cause of the Correa administration's ability to increase taxes would be less structural power of the business sector. High oil-revenues allow the public sector to invest and implement policies without the consent of the business sector. However, a closer look at the sequences of change shows that political developments, not necessarily linked to resource revenues, actually started the process of change.

From the perspective of instrumental power, a low level of political power resources on the part of the economic elites has been the root cause of changes in Ecuador's tax policies. Meanwhile, from the perspective of structural power, the main cause for changes in Ecuador's tax policies has been resource-induced government autonomy and a low level of business investment power. Both factors relate to the degree autonomy of government from economic elites. An important question to discuss is the relation between both factors. Has the decrease in instrumental power of business elites been caused by the loss of structural power or rather as a parallel, but independent political development? I discuss the relevance of both factors that are in line with hypotheses H2a and H2b in the ensuing paragraphs.

Hypothesis H2a refers to the increase in oil-revenues as the causal factor that leads to government autonomy, which is necessary to launch the 'virtuous cycle' based on the available public resources for investment. Increased resource revenues strengthen the bargaining position of the incumbent government vis-à-vis economic elites by reducing the threat of less private investments (see Fairfield, 2013). When the available oil revenues increased sharply in 2008, the government did not respond with tax cuts or by softening collection efforts. Public spending increased from 24 to 34.5 per cent of GDP (MINFIN, 2013). In 2007, oil revenues did not increase relative to GDP, while GDP growth was at a modest 2 per cent (MINFIN, 2013; Ray & Kozameh, 2012). Public spending only increased gradually. Ecuador was certainly not in a fiscal crisis, but neither was there a sharp increase in oil-revenues that would confirm a simple mechanism of resource-induced government autonomy.

It was rather its political agency, which enabled the Correa government to regain control over the use of oil revenues in 2008. The renegotiation of public debt in the same year and of oil contracts in 2010 coincided with a discourse in defence of national sovereignty.

Their political relevance for the Correa government thus extended beyond the net fiscal gain. The confrontation with foreign economic interest has not led to a neglect of domestic revenues. Yet, a look at the sequences of events shows that increased resource revenues cannot be seen as the cause behind the more robust approach against tax evasion and attempts to increase taxes. Key tax policy decisions were already taken in 2007 and thus prior to the significant increase of available oil revenues in 2008.

Hypothesis H2b refers to redistributive struggles and the political influence of economic elites. The constitutional assembly passed the revenue-increasing Tax Equity Law<sup>32</sup> against the protest of business leaders who questioned the legislative faculty of the constitutional assembly other than working on a new constitution. It was an important first legislative change in Ecuador's new tax policy as it contained an increase in the top marginal rate of the personal income tax and tools to fight tax evasion and elusion (Carpio Rivera & Carrasco Vicuña, 2012). It also made changes in the institutional setting that strengthened the executive in fiscal policy matters and formulated new constitutional goals for fiscal policies (Carpio Rivera & Carrasco Vicuña, 2012). In parallel, important changes concerning the revenue authority were made: Carlos Marx Carrasco Vicuña, an economics professor from Cuenca of clear leftist orientation and without links to the Quito and Guayaquil business elites, became head of the SRI. A department for large contributors was established in order to strengthen efforts against tax evasion. In 2008, the SRI established a centre for fiscal studies<sup>33</sup> in order to strengthen its capacity to plan and evaluate tax policy measures.

It is important to comprehend the mechanisms behind the loss in instrumental power resources. In accordance with the state capture paradigm, the counterpart to a state captured by economic elites would be their replacement by a new winning coalition, for instance with closer links to popular sector organizations (see Timmons, 2005). Meanwhile, the state autonomy paradigm is focused on the state's power to take decisions independently of groups in society. I regard both as ideal types that help to frame the changes that have occurred in Ecuador.

In the first scenario, the instrumental power resources of economic elites confront the interests of popular sectors who seek more equal distribution. Based on the democracy and redistribution literature (Acemoglu & Robinson, 2006), an increase in taxes can be explained by the popular sectors' interest in redistribution. Policy outcomes reflect the relative power of different groups in society (Timmons, 2005). The counterpart to the loss of grip on the political process by economic elites would be a state captured by popular sectors, represented by social movements and trade unions. In Ecuador, social movements played a major role in the ouster of previous governments and mobilised against neoliberal policies (Wolff, 2008). The increases in public spending, especially with regard to the social sector, could thus be regarded as a result of their increased access to and presence within the new government. However, various arguments stand against the state capture proposition. The Correa government cannot be regarded as a tool of social movements, but has rather taken an anti-corporative stance (Wolff, 2010). It is not organically linked to either of the regional, ethno-cultural or unionist protest movements and its relation to social movements is ambiguous and at times confrontational (Becker, 2013). The loss of

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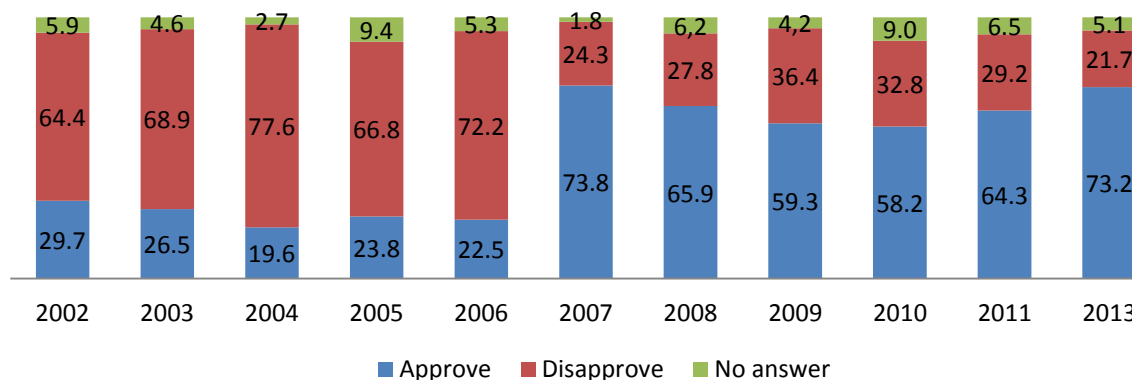
32 Ley de Equidad Tributaria.

33 Centro de Estudios Fiscales, CEF.

business instrumental power resources was not replaced with the privileged access of social movements. It is more closely related to the conceptualization of a transition from a state that is captured by business elites to a state that relies on higher levels of autonomy.

Regarding Ecuador's recent past, Jonas Wolff (2010) points out that the political conflicts have by and large been solved peacefully, however only partially based on the rules formally established. The ability to develop consistent fiscal policies was limited by politics based on clientelist negotiations of particular benefits and returns. This was reflected by countless budgetary pre-assignments that restricted the ability to mobilise resources in line with development objectives (Presidencia de la República, 2015, 12 September). The fragmented party system mirrored regional divisions and power struggles between numerous interest groups, resulting in gridlock between the legislative, the executive and the judiciary. Correa's 2006 electoral campaign was antagonistic to the existing institutions, thereby incorporating the sentiment of the 'Forajidos' movement that toppled Lucio Gutiérrez in 2005. Its slogan – 'They shall all get out' – had expressed discontent with the intertwinement of political and economic elites. In his public discourse, Correa contrasted the spurned existing institutions and perceived lack of sovereignty with his promise to restore a proud, inclusive and more just country. To express the willingness to change, Alianza PAIS demanded a new constitutional assembly and refrained from presenting candidates for Congress (Wolff, 2010).

**Figure 7: Approval rating of the President/Government, in per cent**



Source: Corporación Latinobarómetro (1995-2015)

After Correa's election, the new government's approval ratings reached 73.8 per cent. It confronted a Congress that according to Latinobarómetro polls was evaluated as either bad (36 per cent) or very bad (51 per cent) – in sum, a negative perception of 87 per cent (Corporación Latinobarómetro, 1995-2015). The election of a constitutional assembly in November 2007 resulted in a majority for Alianza PAIS. The public support for the new administration was hence rapidly converted into legislative strength. This made it possible to carry out important fiscal policy reforms and to establish a new institutional setting. At this point, the instrumental power of organised business associations was at a low point. The party-political system, to which established channels of influence existed, fell apart and the political veto power of private business was undermined.

These considerations confirm the assumption of the Correa government's relatively high level of autonomy from business interests (Wolff, 2010). Given that this fiscal policy path had already been taken prior to the rapid increase in oil revenues in 2008, it would be misleading to point to the increase in oil-revenues as the main cause for the government's focus on more robust measures against tax evasion. The political support for a more robust fight against tax evasion was made clear by Correa himself on multiple occasions ("Correa promete acabar con evasión de impuestos", 2007, 6 May; "Correa anuncia cárcel para evasores", 2007, 30 December; "Evasores de impuestos irán a la cárcel", 2007, 29 December).<sup>34</sup> Despite an overall perception of high tax obligations, various factors hampered public opposition to the concrete policy steps taken by the new government.

- The business sector itself was poorly suited to replace the party political opposition, given that 73.4 per cent of those surveyed expressed a negative perspective on the private sector.<sup>35</sup>
- The sectoral and regional divisions of the business sector hampered its ability to take a unified stance against government policies (Fairfield, 2015). The Correa government maintained a dialogue with individual business leaders and did not take radical steps that would have unified the fragmented business elites against it (Wolff, 2010).
- The reality of widespread tax evasion also contradicted the notion of horizontal equity (Fairfield, 2015) and can be interpreted as a mechanism of political rent distribution. As a strong government with parliamentary majority and without close ties to any of the business elites, the Correa government did not feel compelled to continue the pattern of rent distribution just described.

However, this is not to deny the medium-term effect of increased resource revenues on the public sector.

## 5.2 The return of the state

In the previous subsection, I have pointed out that the erosion of the established political party system and weakening of business' instrumental power led to important political-institutional changes. This enabled the Correa government to channel increased oil-revenue to the public sector. I have thus made the case for the political economy perspective that highlights increased government autonomy from economic elites as the starting point for changes in Ecuador's tax policies. Furthermore, I have pointed out that the first phase of changes in tax policies just analysed corresponds rather to a decrease in the economic elite's instrumental power resources than to an automatic development triggered by a decrease of structural power of the economic elites due to the availability of

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34 An interesting argument can be made with regard to the relation between persuasion and enforcement mechanisms used by tax authorities and tax morale. While an exaggerated focus on coercion can backfire, a lack of enforcement can also have negative effects on tax morale as it signals the fact that paying taxes is not regarded as an important civic duty. "In theory, enforcement could even amplify intrinsic motivation by signalling that tax compliance is an important legal or civic duty, although field interventions to date have not been designed in a way that would allow us to test for such effects" (Luttmer & Singhal 2014, p. 156).

35 It can be assumed that the degree of rejection of specific business groups that were regarded as responsible for the 1999/2000 crisis and part of 'corrupted politics' was even higher.

oil revenues. The change in power relations also resulted in important institutional changes, most visible in a new constitution. Alianza PAIS failed to reach a parliamentary majority in 2009. However, the Constitution of 2008 gave strong faculties to the executive as regards economic policy measures and helped to prevent any parliamentary alliance from reversing efforts made earlier.

In the second step of the ‘virtuous cycle’, I focus on the use of increased revenues and the effects of increased public spending and investment. As we shall see, the appropriation of increased resource rents by the public sector has had important effects on the state’s ability to improve its capacity. However, the return of the state cannot be based on increasing resource revenues alone, as this can lead to an overexpanded and wasteful public sector and thus to less acceptance of taxes.

An increase in public expenditures can be regarded as an important characteristic of the Correa government. A major concern from the perspective of rentier state theory is that resource-based income might be used to create an overextended public sector. A mere increase in the size of the public sector is thus often criticised from a rent theory perspective as resource revenues are expected to create overexpanded states. Karl (2004, p. 666) argues that:

oil dependence encourages the expansion of states into new arenas while weakening opportunities to strengthen administrative capacities, especially non-oil-based tax systems, merit-based civil services, and the rule of law – fundamental elements for creating efficient states.

I argue that the state’s comeback as a central development actor has led to better planning, better investment and better public services. Two factors have been key to this development: A new institutional setting that has provided the basis for a more efficient and transparent use of public funds, along with the related ability to use increased revenues to improve public and social services and to implement infrastructure investments that remove obstacles for business developments.

Another is that the weakness of economic elites has led to a new type of state capture, this time by trade union and social movement representatives. I reject this notion and argue that such replacement has not taken place as, in contrast, the Correa government tends to be characterised by a preference for technocrats and fairly conflictive relations with some of the social movements and trade unions (Becker, 2013; De la Torre, 2013). Correa has sown the seeds for a radical renewal of public institutions and state-society relations. The government is dominated by progressive intellectuals and has incorporated functional elites rather than organic representatives of social movements.<sup>36,37</sup> In other words, the loss of the instrumental power of economic elites did not translate into an increased presence of social movement representatives within the government.

The implementation of policies, which serve broad segments of *popular sectors* must not be the result of state-capture by social movements. The social spending of central government had remained at comparatively low levels of less than 5 per cent of GDP prior

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36 Leading Alianza PAIS politicians had expressed their lack of faith in the country’s new social movements (Bustamante, 2003).

37 The more state-led approach gained strength after the electoral victory, while part of the indigenous movement, trade unionists and environmentalists started to distance themselves from the government.

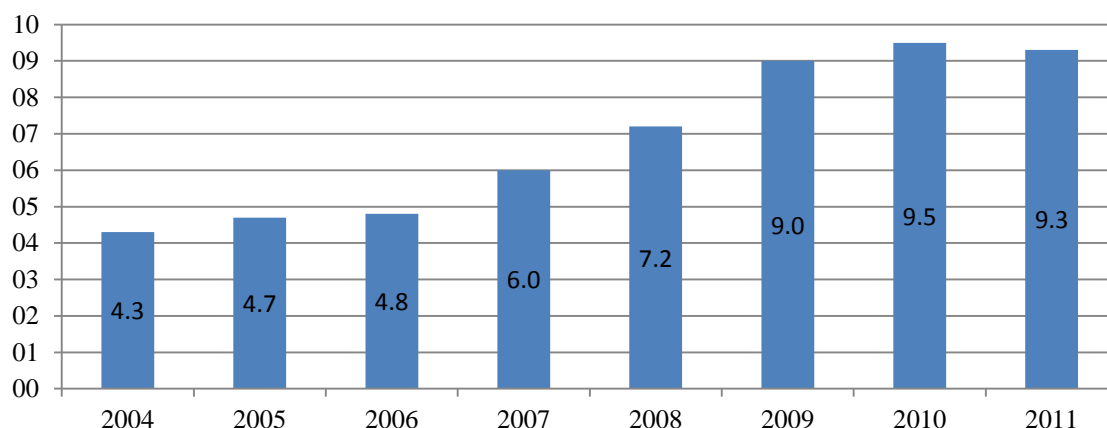


to the Citizens' Revolution. It was significantly increased and reached 9.5 per cent in 2010 (see Figure 13). Meanwhile, the cost of servicing foreign debt decreased from USD 2.39 billion in 2006 to USD 1.284 billion in 2013 (SENPLADES, 2014). The spending for education was increased from 2.6 per cent of GDP in 2006 to 5.3 per cent of GDP in 2009 (Ray & Kozameh, 2012). The education system has extended its coverage to disadvantaged sectors.<sup>38</sup> The Correa government has also continued and increased direct transfers to the poor. This increase in social spending has been important to strengthen the support that the government receives from popular sectors. In a power-based model of tax policy, the parallel steps towards higher social expenditures and more progressive taxation can be understood on the basis of democracy and redistribution literature (Acemoglu & Robinson, 2006, p. 15). However, the return of the state is not limited to the social sector. The increase in social spending has been significant in Ecuador compared to the past, but is still below the average for Latin American (Oxfam, 2013). It is difficult to estimate which social class has benefited the most from the massive increase in public investments in road infrastructure, internet connectivity, energy production, university education, irrigation systems, and so on. Furthermore, as income taxes are primarily paid by corporations, their interest in public investments that help to overcome collective action problems and bottlenecks for private sector development must be considered (Redacción Actualidad, 2015, 12 January).

The state itself has increased the degree to which it acts independently of interest groups. This increase in autonomy allowed the government to channel resource revenues towards investments, as demanded by the new constitution. Between 2007 and 2014, Ecuador's current spending amounted to 13.8 per cent of GDP and thus remained below the regional average of 17.1 per cent, while Ecuador invested 9.6 per cent on average. The regional average lay at 4.3 per cent ("Patricio Rivera: Ecuador no gasta mucho, invierte mucho", 2015, 24 May). As mentioned in the previous section, 2008 marked a sharp increase in government spending and investment. Compared to 2006, the ratio of public investment to GDP more than doubled, from 4.2 to 11.3 per cent in 2008. Thereafter, public investment was kept at levels above 10 per cent and reached 15.5 per cent in 2013.

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38 The rate of primary school attendance of ethnic children was increased to the general level; these minorities' share in tertiary education was also increased (Ministerio de Educación [MINEDUC], 2014).

**Figure 8: Central government social spending in percentage of GDP**

Source: Ray &amp; Kozameh (2012)

Within the executive branch, the National Secretariat of Planning and Development (SENPLADES) has emerged as the hegemonic entity that coordinates the implementation of the national development plan and is the core institutional expression of the new emphasis on development planning (Muñoz & Ubasart, 2015; Viteri, 2012). Furthermore, the need to increase efficiency in public sector purchases, property management and construction projects is being given a higher priority. A more efficient and transparent system of public purchases was constructed from 2008 onwards: it excludes providers that have debts with the SRI or Social Security payments while providers that have been declared as failing to meet their obligations in previous projects are excluded for five years. Furthermore, standardised models that are used for the construction of education and medical facilities decrease prices and increase transparency. The return of the state is also based on laying emphasis on the improvement of public service. The improvements are reflected in Inter-American Development Bank (IADB) evaluations (Redacción Economía, 2015, 8 September). Last but not least, it is related to the focus on establishing a merit-based civil service (Stefanoni, 2014).

### 5.3 Achieving sustained tax revenue increases

Having analysed the return of the state with regard to institutional changes and its increased material importance, one should turn to the next step of the ‘virtuous cycle’, namely achieving acceptance of changes in tax policies based on improved relations between the state and society. This is essential in rendering the fiscal policy advances sustainable. The key idea is that increased state legitimacy and satisfaction with public services helps to sustain improvements in tax collection.

While the data in the previous subsection was taken from official statistics, I will now focus on the perception of changes and mainly rely on polling data: Latinobarómetro polls provide evidence of citizens’ perceptions and data from the WEF’s Executive Opinion Survey on the perspective of the business sector. I will also refer to qualitative information based on semi-structured interviews.

I begin by addressing how these factors relate to the various different theoretical perspectives. Thereafter, I focus on empirical evidence on citizens' perception of changes in general and the perspectives of economic elites in particular. The latter is especially important from the angle of fiscal sociology that highlights the need for cooperation and the high costs of coercive enforcement of taxes (Moore, 2008; Timmons, 2005;). According to the fiscal contract paradigm (see Subsection 2.2), those paying for the increased tax-to-GDP ratio are expected to also be the benefiter of improved state capacity. The Executive Opinion Survey focuses on corporate executives and is thus not representative of all high income earners. Nonetheless, it represents a good proxy as there is a strong overlap between company owners, management and economic elites.

From the political economy perspective, the focus is on the politically incumbent government. In fact, the satisfaction with public goods and services did indeed increase during the Citizens' Revolution. Polling data shows a positive tendency in the evaluation of public services (Muñoz López & Ubassart, 2015). Satisfaction with public education, public healthcare, the police and the civil registry increased significantly in the period from 2009 to 2011 and reached clearly positive majorities. This is less so for the judicial system.<sup>39</sup> In 2011, 56.3 per cent of respondents of a Latinobarómetro poll answered that public education was better than ten years before, while only 7.2 per cent said the opposite was the case (Corporación Latinobarómetro, 1995-2015). There is a recent tendency towards an increasing demand in public school education with a significant number of students crossing from private or semi-private schools to the public system (Redacción Sociedad, 2014, 2 May). In general, the Latinobarómetro polling data shows a significant increase in satisfaction with public services.

From the fiscal contract perspective, the way taxpayers perceive the situation is most relevant, given that personal income tax is only paid by a fairly small minority of citizens and taking into account that corporate taxes are the main source of direct taxes. I focus on data available on how corporate executives perceive this. The Executive Opinion Survey reveals that the perception of the country's educational system has clearly improved among executives. However, it can be assumed that a high percentage of the wealthy neither send their children to public schools nor rely on public healthcare facilities. It thus seems unlikely that improvements in social services would have a positive effect on their willingness to pay taxes.

**Table 3: Executives' perception of public institutions**

	2006	2008	2009	2010	2011	2013	2015
Quality of the educational system (ranking)	119	125	122	122	105	62	71
Quality of the educational system (Score 1-7)	2.3	2.5	2.6	2.8	3.2	3.8	3.6
Number of countries included	125	134	133	139	142	148	140
Source: World Economic Forum [WEF] (2006-2015)							

<sup>39</sup> However, a major justice reform was launched in 2011 after approval for the necessary constitutional changes was attained via a plebiscite ("El CNE proclamó los resultados oficiales de la consulta popular", 2011, 12 July).

Despite the low ratings given to the educational system, the education of Ecuador's workforce prior to and in the first years of the Correa administration was not seen as one of the most pressing problems for doing business. Public health had an even lower priority.

**Table 4: Education and health as a problem for doing business**

	2006	2008	2009	2010	2011	2013	2015
Inadequately educated workforce	2.34	3.3	3.5	1.6	3.4	4.4	7.1
	12/14	9/15	9/15	12/15	11/15	10/16	7/16
Poor public health	-	1	1.1	0.1	1	0.9	0.8
		14/15	14/15	15/15	15/15	16/16	16/16
Notes: From a list of factors, respondents were asked to select the five most problematic for doing business in their country/economy and rank them between 1 (most problematic) and 5. 2006 – 14 factors; 2008 to 2012 – 15 factors; 2013 and 2015 – 16 factors.							
Source: WEF (2006-2015)							

An important change can be seen both with regard to the overall quality of infrastructure and to the quality of roads. This is reflected in this significant change of perception. Hence, the improvements are clearly recognised by the business community.

**Table 5: The perceived quality of infrastructure**

		2006	2008	2009	2010	2011	2013	2015
Overall quality of infrastructure	Ranking	84	105	99	98	91	75	45
	1-7 Score	2.8	2.6	3.1	3.5	3.7	4.2	4.6
Quality of roads	Ranking	82	100	103	83	61	50	25
	1-7 Score	2.7	2.6	2.8	3.5	4.2	4.6	5.2
Number of countries included		125	134	133	139	142	148	140
Source: WEF (2006-2015)								

To sum up, there is reason to believe that satisfaction with public services and infrastructure has improved among the general public as well as among economic elites. However, the improvements could be solely due to higher oil revenues. It could even be the case that, while the perception of public goods and services has indeed improved, the efficiency of and the trust in the state has decreased. This can be due to increased waste and favouritism in government spending.

It is thus important to take a closer look at various aspects of state legitimacy. In 2013, 62 per cent of respondents said that Ecuador was generally governed in favour of the whole population, the highest rating in the region (Corporación Latinobarómetro, 2015, p. 64). Trust in Ecuador's national Congress was close to non-existent in 2006 when 0 per cent declared that they had a great deal of trust and 6 per cent some trust in the institution. In 2013, 16 per cent declared that they had a great deal of trust and 35 per cent some trust in the National Assembly. Asked about their satisfaction with democracy, 3 per cent declared they were very satisfied while 19 per cent said they were fairly satisfied in 2006, while 12 per cent declared they were very satisfied and 47 per cent they were fairly satisfied in 2013.

<b>Table 6: Confidence in Congress/National Assembly</b>									
	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2013</b>	<b>2015</b>
Much	1%	0%	1%	10%	4%	2%	7%	16%	10%
Some	12%	6%	5%	27%	21%	21%	39%	35%	26%
Little	26%	28%	32%	38%	42%	42%	34%	29%	42%
None	58%	66%	61%	24%	29%	32%	18%	20%	22%
Does not answer	0%	0%	-	0%	1%	0%	0%	0%	0
Does not know	2%	1%	1%	2%	2%	2%	1%	0%	0
(N)	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200
Source: Corporación Latinobárometro (1995-2015)									

The poll results reveal a general tendency towards higher approval ratings of public institutions in accordance with the Latinobarómetro polls. There are thus strong indications that the state has gained legitimacy as a provider of public services in the context of the Citizens' Revolution.

This can be seen as an indication of the political strength of the incumbent government and certainly increased its ability to implement its policy agenda. This development is also reflected in the results of the WEF's Executives Opinion Survey. The risk of a coup and political instability were regarded as key problems for doing business prior to the Correa administration, while these factors played a minor role in the 2013 and 2015 surveys.

<b>Table 7: Government instability as a major problem for making business</b>							
<b>The most problematic factors for doing business</b>	<b>2006</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2013</b>	<b>2015</b>
Government instability/coups	17.78	13	5.7	6.7	4.2	1.1	1.4
Policy instability	15.01	19.9	19.6	17.8	12.5	4.3	5.2
Notes: From a list of factors, respondents were asked to select the five most problematic for doing business in their country/economy and rank them between 1 (most problematic) and 5. 2006 – 14 factors; 2008 to 2012 – 15 factors; 2013 and 2015 – 16 factors. The Global Competitiveness Report's data is based on a survey of corporate executives.							
Source: WEF (2006-2015)							

However, this does not necessarily coincide with the way private business elites perceive the matter. Their perspective is especially important according to fiscal sociology approaches that point out the costs and limitations of coercive taxation and thus focus on the need for cooperation by taxpayers. From this perspective, the perception of public institutions can be regarded as a key factor for the ability to tax.

The Executive Opinion Survey indicates that the way executives perceived institutions was developing in a generally positive manner. The most notable positive change can be seen when we compare the ranking in 2013 to the rankings in 2010 and 2011. Even though Ecuador still scores low with regard to judicial independence and the efficiency of the legal framework, the overall perception of public institutions has improved significantly. In key categories, the survey suggests positive changes. In the 2013 edition, Ecuador ranked 42 out of 148 with regard to the wastefulness of government spending, whereas, in 2006, the country had ranked number 122 out of 125 countries.

<b>Table 8: Evaluation of Ecuador's public institutions</b>							
		<b>2006</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2013</b>
Property rights		110	125	116	123	123	98
		3.4	3.2	3.3	3.2	3.2	3.8
Intellectual property protection		-	123	126	128	106	79
		-	2.4	2.3	2.5	2.7	3.6
Judicial independence		116	129	130	135	130	100
		2.2	2.0	2.0	2.0	2.3	3.2
Efficiency of legal framework	in settling disputes	-	129/ 2.2	119/ 2.7	135/ 2.5	135/ 2.5	97/ 3.4
	challenging regulation			122/ 2.6	132/ 2.5	137/ 2.4	100/ 3.1
Irregular payments bribes		95	-	-	103	100	92
		3.9	-	-	3.3	3.4	3.6
Favouratism in decisions of government officials		122	122	115	112	81	47
		2.0	2.2	2.4	2.6	2.8	3.4
Wastefulness of government spending		122	127	126	133	100	42
		1.8	2.2	2.1	2.1	2.7	3.6
Diversion of public funds		117	121	123	130	117	68
		2.2	2.4	2.2	2.1	2.5	3.2
Transparency of government policymaking		-	131	122	112	99	73
			2.9	3.4	3.7	3.9	4.1
Burden of government regulations		105	110	100	97	97	68
		2.4	2.7	2.8	2.9	2.9	3.5
Reliability of police services		111	126	120	120	118	106
		2.8	2.4	2.8	3	3.1	3.6
<b>N</b>		<b>125</b>	<b>134</b>	<b>133</b>	<b>139</b>	<b>142</b>	<b>148</b>
Note: Respondents were asked to rate the performance of institutions from 1 to 7, where 7 was the highest performance level. Source: WEF (2006-2013)							

While the tax-to-GDP ratio and overall fiscal pressure increased, polling data indicates that the percentage of citizens who regard taxes as ‘very high’ has dropped. This development can be interpreted as a tendency towards a higher acceptance of taxes. However, while the number of contributors has increased significantly – under the Correa administration from 700 thousand to 1.6 million in 2014 – there is still a large majority who do not pay direct taxes. Only about 4,000 contributors are affected by the increase in the top marginal rate of personal income tax (“El número de contribuyentes pasó de 700 mil en 2008 a 1,6 millones de personas” [Interview with Ximena Amoroso, general director of the SRI], 2014, 24 September). The collection of indirect taxes has been improved without raising tax rates. Attempts by previous governments to increase consumption taxes had sparked major popular uproar and hence proved to be a politically delicate issue.

From a political economy perspective, the main focus must be on the political sustainability of tax policies. The decrease in the percentage of respondents who regard tax levels as either ‘high’ or ‘very high’ is important, as this tendency makes it more difficult for a political

campaign based on the rejection of taxes to be successful. The results of the 2013 election indicate that increased fiscal pressure was at least accepted passively by a majority of the population. Leading opposition candidates<sup>40</sup> offered tax cuts and criticised increased government expenditures as waste, yet this strategy did not prevent the quasi unchallenged electoral victory of both Correa in the presidential and Alianza PAIS in the parliamentary elections.

#### 5.4 Limitations and countervailing tendencies

The Correa government felt less obliged to negotiate with the private sector or to concede specific areas of government to its representatives. As mentioned, this has formed part of its political platform of anti-corporatism, yet the sustained popularity and strength of this approach was related to its ability to implement investment projects and thus visible improvements for citizens, leading to a more positive perception of the state. However, the government's orientation towards a more state-led development does not seek a replacement of the private sector by the state, nor does it offset the restraints of market-capitalism. Public investments are not meant to replace the private sector, but to provide the necessary conditions for private investments.

It would appear that the Correa government accepts the fact that development objectives, such as a profound change in the productive matrix, can hardly be achieved without cooperation and input from the private sector. The challenge remains of improving cooperation with the private sector in a coherent way, while counteracting rent-seeking behaviour. Leading business representatives have recognised that a more robust strategy for tax collection is necessary, given the high levels of tax evasion in the country. Nonetheless, the dispute about taxes has not translated into a generalised opposition to the government. Most business leaders have not taken an openly confrontational attitude to the government, which has started to reach out, searching for productive private-sector investments in order to reach its development objectives (Wolff, 2016).

The increased state autonomy has been achieved within the structural limits of capitalism. Furthermore, the business sector has become increasingly able to exercise influence within the new institutional framework. In practice, there has not been a linear trend towards more redistributive tax policies. The general tendency towards higher tax revenues and an increased importance of direct taxes cannot disguise the fact that the business sector has remained the government's main counterpart regarding tax policy decisions. The initial push back against instrumental power based on corporatist arrangements and linkages to political parties has not led to a lineal decrease in business power. For instance, the Coordinating Ministry of Production, Employment and Competitiveness (MCPEC) has led the elaboration of the Code of Production, which was enacted as of in 2011. The Ministry in general and Minister Nathaly Cely in particular can be regarded as business-friendly<sup>41</sup> (Mazzolini, 2015, 1 December; Burbano de Lara, 2015, 25 August). The reform provides tax reductions and incentives to the private business sector. This, and following laws that

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40 Judged by the electoral results, these were Guillermo Lasso and Lucio Gutiérrez.

41 SRI experts tend to be more skeptical with respect to the effects of tax incentives on investments and production.

entail tax incentives, indicate that the importance of tax cuts to attract investments might still be overrated when considering the lost revenue (Oliva, 2014, 24 November).

In the previous section, I pointed out the acceptance for increased fiscal pressure. However, when we look at the acceptance for taxes, an important concern must be with those who are actually paying direct taxes. The Executive Opinion Survey indicates that tax rates and the complexity of tax regulations have become increasingly perceived by executives as a problem for doing business. While there has been some variation during Correa's time in office, the comparison between 2006 and 2013/15 indicates that the issue of taxes has become a major concern for the business community, while it was not the case prior to the Correa administration.

<b>Table 9: Taxes as a problematic factor for doing business</b>							
	<b>2006</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2013</b>	<b>2015</b>
Tax rates	2.69	4.5	5.1	5.9	5.0	8.3	13.7
Tax regulations	2.83	5.6	7.1	10.2	6.9	8.9	12.2
Notes: From a list of factors, respondents were asked to select the five most problematic for doing business in their country/economy and rank them between 1 (most problematic) and 5. 2006 – 14 factors; 2008 to 2012 – 15 factors; 2013 and 2015 – 16 factors. The Global Competitiveness Reports is published in the respective years. The data is based on a survey of corporate executives.							
Source: WEF (2006-2015)							

## **6 Progress and apparent limits to further improvements**

In the present analysis, I have examined changes in Ecuador's tax policies within the context of the Citizens' Revolution, from Correa's first election in 2006 to his second re-election in 2013. Except for 2009, these changes took place in a context of relatively high oil revenues and economic growth.

I have also provided as short summary of changes in fiscal policy in previous periods. This analysis shows that the fiscal system was not strengthened in times of high resource revenues, for instance by the military regime of the 1970s. I have also taken into account tax increases and the establishment of the SRI in the late 1990s, which can be seen as reactions to severe problems in financing the state. The establishment of the SRI is certainly related to the work of international development cooperation (see Arraiz, 2008) but also to Ecuador's urgent need for tax revenues in order to pay creditors and to sustain basic public services. However, the establishment of the SRI was an isolated measure which was implemented while trust in the state as a whole and the satisfaction with public services remained low. Measures to restrict government spending after the 1999/2000 crises did not set the country on a path to an implicit fiscal contract, but rather undermined citizens' trust in the public sector even further. The size of the state and its ability to act as an agent for development were certainly restricted, while a fragmented form of corporatism arrangements gained importance.

With regard to the 'virtuous cycle' of tax policies within the context of the Citizens' Revolution, I have explored the importance of available resource revenues as well as the significance of political developments. The sequence of events and the analysis of the



political situation at the beginning of the Citizens' Revolution indicate that the instrumental power of economic elites was severely affected by the surge of the leftist Correa government and the crisis of the established party system. It was hence the crisis of established political-economic elites that enabled the Correa government to implement tax policy changes and start a profound process of institutional change. Nonetheless, I recognise the importance of oil revenues as an important source of government power to act in autonomy from economic elites<sup>42</sup> and its ability to increase public investment. It also enabled the Correa government to push for important institutional changes, which have made the state more coherent and less prone to accept rent-seeking behaviour by economic elites and corporatist arrangements. There is an ex-post acknowledgement of business representatives that many of these changes have been necessary. Nonetheless, as Table 9 indicates, the rejection of taxes has become an increasingly important issue among executives. Thus, the improved state capacity, recognised by executives, has apparently not led to a higher acceptance of taxes among them.

The oil price started to decrease in the second part of 2014 and has not recovered since. Ecuador is adjusting to this new reality. The government has calculated its 2016 budget based on USD 35 a barrel and lowered this expectation to USD 25 a barrel in February 2016 (Noticias de América Latina y el Caribe [NODAL], 2016, 25 February). Given this situation, it seems opportune to analyse apparent limits to further improvements in a country that despite all advances still lacks important infrastructure and remains highly unequal.

In the following subsections, I first summarise fiscal policy responses to massive external economic shocks (Subsection 6.1). Here, I look both at the adjustment measures on the spending and on the revenue side. After that, I analyse the fate of redistributive reform proposals in the new political economic context (Subsection 6.2). Finally, I enumerate obstacles for further advances on the path towards progressive taxation from the perspectives of structural and instrumental power (Subsection 6.3.).

## 6.1 Fiscal policies in times of economic turmoil

The 2013 electoral victory of Alianza PAIS did not lead to more decisive steps with regard to increasing tax revenues. Despite their electoral defeat in 2013, opposition parties continued to claim that taxes were too high and that resources were wasted.<sup>43</sup> As pointed out, the available non-tax revenues have diminished severely since the second half of 2014. Within few months, the context of tax policymaking changed dramatically. In the following paragraphs, I investigate fiscal policy measures of adjustment aimed at three objectives: to raise revenues, to cut spending, and to stabilize the balance of payments.

In December 2014, the Law on Production Incentives and Tax Fraud Prevention passed the National Assembly (Agencia Pública de Noticias del Ecuador y Suramérica [ANDES], 2014, 23 December). The government draft was expected to achieve a net increase in

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42 I apply the term in analogy to the concept of business structural power (Fairfield, 2015).

43 On the municipality level, the electoral victory of Mauricio Rodas in Quito was based not least on a campaign against municipal taxes and charges. Opposition newspapers interpreted the change of SRI-Director Carlos Marx Carrasco from the tax authority to the Ministry of Labour as a reaction to the sobering electoral results in the subnational elections. Carrasco had been a rather outspoken defender of Quito's Alianza PAIS mayor, Barrera (Redacciones, Política, Negocios y Cuenca, 2014).

revenue of USD 200 million<sup>44</sup> (Redacción Negocios, 2014, 10 December). The government's most successful measure to increase domestic tax revenues in 2015 was a relief from interests and charges for taxpayers who were willing to cancel their tax liabilities. USD 932 million were collected as a result of this measure (Revista Líderes, 2015, 30 July). This increased revenues in the short-term, but tended rather to be a concession to the private sector. Adjustment measures were also taken, in order to protect dollarization under adverse circumstances. While revenues from oil exports plummeted and the value of other export commodities decreased, the dollar increased in value, thus rendering Ecuadorian products less competitive on the world market. For this reason, Ecuador's government introduced tariff safeguards of up to 45 per cent. Rather than a measure to increase fiscal revenues, this aimed at stabilising the trade balance of Ecuador's dollarized economy and protecting domestic production and employment.<sup>45</sup>

In the first days of 2015, a major budget cut was announced. The original budget approved in November 2014 foresaw a total government spending of USD 36.317 billion, including USD 8.116 of central government investments<sup>46</sup> (ANDES, 2014, 20 November). The budget was reduced by USD 1.42 billion to USD 34.897 billion. Investments were cut by USD 839.9 million and current expenditures by USD 580 million ("Ministro de Finanzas anuncia recorte de \$ 1.420 millones en Presupuesto General del 2015", 2015, 5 January; "Presupuesto 2015 tendrá USD 1.420 millones menos 2015", 6 January). Further budget cuts of USD 100 million in current expenditures and USD 700 million in investments followed in August 2015 as the oil price remained at low levels (MINFIN, 2015, 19 August). Various additional measures to stabilize the balance of payments were taken, including a focusing of spending cuts on import goods. Assuming that the period of low resource revenues might be of rather short duration, apart from tax policy measures and budget cuts, Ecuador also tried to use foreign loans, as a recourse to counteract falling revenues with China being the main creditor ("\$7.526 millones en créditos chinos vendrán en partes", 2015, 8 January; Redacción Política, 2016, 31 January).

In short, despite the broad Alianza PAIS majority, the decrease in resource revenues coincided with increasing political difficulties. In general terms, the policy responses to the decrease in revenues with regard to domestic taxation have been rather timid. So far, the need for revenues has not resulted in radical changes in tax policies in order to make up for the loss in oil revenues (Paz y Miño Cepeda, 2015).

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44 The National assembly exempted electric induction cookers from the VAT tax in order to introduce a stronger incentive for their purchase, while gas cookers were charged with special consumption taxes (ANDES, 2014, 23 December).

45 It was not only import-based commercial elites who protested against this measure: despite the focus of tariff measures on luxury products and products with an available domestic substitution, part of the trade union and indigenous movements also referred to these custom duties as anti-popular measures that would increase the cost of living ("Sobretasas seran motive de protesta; organizaciones preparan marcha para la proxima semana", 2015, 16 March).

46 The budget includes transfers to subnational and autonomous entities, such as municipalities and universities. However, the data on investment does not include the investments that are foreseen by these entities themselves as it only takes into account investments by the central government.

## 6.2 Notes on the fate of redistributive reforms in times of economic turmoil

Nonetheless, in May 2015 Correa proposed two tax initiatives aimed at the redistribution of wealth and against illegitimate profits from property sales: increasing the inheritance tax for large inheritances; and re-focusing a tax on property sales in order to prevent rent-seeking in the real-estate business. Both initiatives aimed at structural change, in particular the reform of the inheritance tax was focused on a medium-term change in the distribution of wealth. Despite the broad majority in the National Assembly, the reform initiatives were not achieved as expected. These more structural reforms have thus been delayed and watered down.

When Correa announced the redistributive reforms during his annual address to the nation, he emphasised that the aim of his proposal was to counteract the concentration of wealth (Correa, 2015, 24 May). However, the reforms did not pass the legislature and were withdrawn by Correa on 15 June 2015 for an undefined period of time (Correa, 2015, 15 June). In view of the political salience of the reform proposals announced by the President himself and the broad majority of Alianza PAIS in the legislature, this development needs explanation. Changes in structural power relations in detriment to the government, increased the instrumental power of the economic elites. Furthermore, mistakes in policy design and the opposition's success with regard to framing tax policies in general and the proposals discussed in the present sub-chapter in specific, can be noted.

With regard to policy design and efforts to frame the reforms, the following was observed: The government framed the reforms as radical measures against wealth inequality and illegitimate income. However, given the economic crises, the assumption that the tax reforms were an attempt to increase public revenues appeared plausible. In this scenario, the media and opposition discourse on a supposedly oversized public sector and wasteful government spending gained strength, primarily through continued repetition (Quiroz, 2015, 3 September; Calderón de Burgos, 2014, 21 November).

The reduction of the tax-free threshold allowed economic elites to gain middle-class support. Certainly, the media access of business elites and their influence on public opinion has remained an important source of their instrumental power. Polls indicate that a majority of the population rejected the reform initiatives in June 2015 based on the information they had received (Centro de Estudios y Datos [Cedatos], 2015). The tax plans sparked anti-government protests and mobilised the country's right-wing opposition to take to the streets of the country's major cities ("Marchas se extenderán en Ecuador desde lado oficial y desde el que rechaza", 14 June; Chamorro 2015, 15 June).

The proposal was also condemned as a tax against the right to prosperity and Ecuadorian families ("Impuesto a la herencia ,es un ataque a la familia'", 2015, 5 June). The opposition framed the President's critique of 'anachronistic' family-owned corporations without professional management as a general attack on family-run businesses. Last but not least, given the decrease in resource revenues, the opposition was able to frame the redistributive tax measures as a government attempt motivated by the aim of increasing revenues. Also the proposal to heavily tax windfall gains from property sales was designed to hit speculators and deals based on insider knowledge at the level of the municipality. The government failed to communicate that the law actually reduced taxes on most property sales. Instead, the 75 per cent rate on extraordinary profits was often wrongly

perceived and portrayed as a confiscatory measure and use to mobilise even middle-class homeowners against it (Acosta-Burneo 2015, 6 July).

As the previous subsection indicated, at the time the reforms were introduced Ecuador was undergoing a process of adjustment. At first, they were also unrelated to any popular benefits and thus poorly suited to mobilise popular sectors (see Fairfield, 2013). Furthermore, various other government initiatives hindered alliances with social movements and trade unions: among those, plans for constitutional changes that would have removed restrictions for Rafael Correa to become candidate in 2017 as well as planned changes in the country's labour legislation. In its opposition to the Correa government, part of the labour and indigenous movement even explicitly mobilised against the highly progressive tax reforms ("Conaie y otras organizaciones se suman a las movilizaciones en todo el país", 2015, 17 June). Thus despite its broad parliamentary majority, the developments just described hint at a much more limited capacity to act on the part of the Correa government than in previous times. Furthermore, adjustment measures produced public discontent. They were opposed by dominant import sectors, but also by consumers and trade unionists as well as part of the indigenous movement ("Sobretasas seran motive de protesta; organizaciones preparan marcha para la próxima semana", 2015, 16 March; "Multitudinarias marchas de protesta en por lo menos ocho ciudades", 2015, 19 March).

The Correa government responded with an information campaign and put tax calculators on its websites, showing the tax reform was highly targeted. The campaign also included the questioning of the tax records of leading opposition figures. Moreover it also started a broad dialogue on social inequality and what to do to overcome it, led by SENPLADES (Redacción Política 2016, 3 January).

However, street protests and other political actions alone cannot sufficiently explain the government's temporary withdrawal of the tax initiatives – given the circumstances of economic difficulties; the strategic use of structural power most certainly played an important role. The massive fall in resource revenues put extreme pressure on the public budget and on Ecuador's balance of payments, which made it increasingly difficult to sustain dollarization. In the first half of 2015, the country faced a severe reduction of deposits in the country's banking system and thus the prospect of a credit crunch. Public expenditures, and especially investments, were cut in order to balance the public budget ("Ministro de Finanzas anuncia recorte de \$ 1.420 millones en Presupuesto General del 2015", 2015, 5 January; ANDES, 2015, 19 August). In this situation, the government's ability to confront the interests of the economic elites was affected. It is normal expectation that business structural power increases in times of economic stagnation as there is a fear that measures against business interests could decrease private investments and lead to a recession. The initial plan to increase tax rates was dropped as economic elites threatened a decrease in private investments ("Marchas se extenderán en Ecuador desde lado oficial y desde el que rechaza", 2015, 14 June). Key business leaders are convinced that the negative effects of the reform with respect to bank deposits and capital flight and the resulting risk for Ecuador's dollarized economy were important reasons to withdraw the reform proposal provisionally.

A year later, the 2016 State of the Nation address showed that the government had not yet given up on its objective of reforming the inheritance tax. Rafael Correa announced that

the reform proposals would soon be sent to the National Assembly again. As a reaction to political pressure and opposition from middle-class sectors, the reform was targeted even more. As a response to fears that the reform would harm productive investments, the new proposal provided exceptions for operating assets (Correa, 2016, May). Already in October 2015, the executive submitted a reform proposal exclusively focused on the fight against tax elusion (“Ejecutivo envió a la Asamblea proyecto para evitar la elusión del impuesto a la renta sobre herencias”, 2015, 24 October). It was finally approved in June 2016, almost exactly a year after Correa had temporarily removed the original and more radical reform proposal. The anti-elusion reform was linked to scholarships for disadvantaged ethnic minorities, migrants and children of single-mothers as well as the indigenous population and Afro-Ecuadorians (Redacción Web, 2016, 16 June). Despite that, the failed attempt at a more radical reform represented high political costs for the Correa government. Furthermore, it probably strengthened resistance against taxation.

### 6.3 Obstacles for further advances

As mentioned in my analysis of countervailing tendencies to the ‘virtuous cycle’, even in times of high oil revenues the government’s development strategy ultimately required the input of the private sector if production patterns were to be changed. Hence, the private sector was given an increasingly protagonistic role. Its developmentalist aims have made the government more sensitive towards the risk that private investments could fail to materialise. This situation was aggravated by a significant decrease in the oil-price that diminished the government’s own investment capacities and increased vulnerability to foreign trade deficits and capital flight (Carvajal, 2015). The structural power of private business has thus increased.

Business elites have not regained the direct influence that they had in the context of fragmented corporatism prior the Citizens’ Revolution. However, they have recovered important instrumental power resources. The business sector remains the primary counterpart of the government in tax policy debates. In March 2015, the President and part of the cabinet met with private business representatives to develop a joint agenda (ANDES, 2015, 2 March). Given the lack of own resources, the government tried to improve its cooperation with the country’s business sector and has shown more openness to dialogue than in earlier years. Dialogue with the business sector had taken place before, but not one that was as visible and comprehensive. The private sector’s structural importance in the economy boosted in times of economic difficulties, which thus contributed to dialogue between representatives of the business sector and the government. Hence, the economic turmoil had important consequences with regard to the distribution of instrumental power.

Meanwhile, representatives of popular sectors seldom voiced their concerns about taxes. To a significant extent, Ecuador’s social movements have remained the reflection of fragmented elites. Bustamente (2003) argued that the movements tend to push for particularistic exemptions instead of universalist policies. Even though trade unions are concentrated in the public sector, given their fragmentation, focusing on higher taxes is unlikely to be a promising strategy. Higher tax revenues are expected to increase general government expenditures, but not to benefit a certain specific trade union constituency. Ecuadorian trade unions and social movements strongly reject consumption taxes. In

doing so, they often adopt the arguments of neoliberal criticism on supposed waste in the public sector. In sum, not only do social movements lack the structural power of business elites, but also their instrumental power.

Last but not least, the economic elite's fierce opposition to reform of the inheritance tax has received the support of so-called middle-class sectors. This development can be regarded as the consequence of government errors with regard to policy design in reducing the maximum amount of tax-free income from inheritances (León, 2015; Rivadeneira, 2015; "Gremios piden derogar leyes", 2015, 19 June). So far, the government has not tried to decrease the threshold for personal income tax (Jiménez, 2015). Where the taxation of middle-class sectors in Ecuador is concerned, there are two problems: One is that officials, intellectuals and senior executives have suggested that the taxation of the middle class – in other words the taxation of their own social group – is not legitimate, thus preventing the construction of a broad tax base. Here, the term 'middle-class' is used without taking into account that the income and property of the individuals referred to as 'middle-class' often places them in a highly privileged position when compared to the vast majority of citizens.

## 7 Conclusions

In the present discussion paper, I have analysed the conditions and political strategies that enabled Ecuador to increase its tax-to-GDP ratio during the Citizens' Revolution. The Ecuadorian case is especially interesting, as the Correa government's focus on tax policies has come at a time of high resource revenues. The most promising finding of my analysis is that, in contrast to expectations derived from rentier state theory, Ecuador strengthened its tax system during a period of high oil revenues. Instead of replacing tax income, resource revenues have contributed to a significant increase in public investments. A crucial concern of my research question has been whether the reforms and the government's more robust stance against tax evasion have been possible because – or in spite of – the resource revenues?

Hypotheses based on various different theoretical assumptions have guided my research on Ecuador's path towards a less regressive tax system and the government's increasing ability to raise taxes. I now contrast these hypotheses with my empirical findings. I am fully aware that findings based on a single case study cannot be generalized; however, my study does hint at the need to carefully question whether or not the implicit assumptions on which different theoretical approaches are based apply.

My first hypothesis (H1) is based on key assumptions of a fiscal policy dimension of the 'resource curse'. Here, the explanation for higher tax revenues and less tax evasion is to be found in institutional reforms that have restricted government access to resource revenues. This view predicts that, as the state is pressured to obtain revenues from taxation, a process of bargaining has developed, leading to higher tax contributions in exchange for government accountability and taxpayers' participation in fiscal policy decisions. The state itself becomes more efficient and begins to take decisions in accordance with its self-interest in a prosperous private sector, rather than based on political interests and preferences. Following fiscal sociology accounts on the historical emergence of a fiscal contract, the driving force for its emergence has been the separation of political and

economic power and thus the state's dependence on taxes and its interest in a prosperous private sector.

With regard to the effects of scarcity on taxation, my empirical findings are ambiguous. I recognise that important measures were taken in times of low resource revenues, economic crisis and urgent needs of revenues in the late 1990s in order to raise revenues. The new semi-autonomous tax authority (SRI) was set up in this context and has contributed to a more efficient and trustworthy tax collection. However, rather than a comprehensive reform of the public sector, the strategy was intended to shield the revenue authority from political interference as well as inefficiency and corruption that has often been associated with the public sector. Improvements in tax collection and higher tax rates led to a significant increase in tax revenues, yet the advances were limited as the tax-to-GDP ratio stagnated at low levels of less than 11 per cent from 2001 to 2006.

In the period after 2000, fiscal austerity measures contributed to a significant reduction of public debt after the financial and economic crisis of 1999 and 2000. At the same time, public investments remained at low levels and urgent investments and highly profitable investments were delayed. The perception of state capacity and the satisfaction with public goods and services remained at low levels, thus undermining citizens' willingness to accept higher taxes. Rather than providing a path towards a fiscal contract, restrictions to government access to resource revenues might lead to a deterioration of how the state is perceived. Underfunded and politically weak governments were not able to initiate reforms and to confront interest groups – not least economic elites – with a view to making the state more efficient and coherent.

As the Correa government did not follow the advice to restrict government access to resource revenues by establishing investment and stabilization funds, such a mechanism cannot be related to its success in strengthening the country's tax system. Instead, the Correa government successfully pushed for the elimination of NRFs in order to attain access to oil revenues. At this point, it is important to emphasise that Ecuador's 2008 Constitution distinguishes between current expenditures and investments. Oil-revenues and loans must be used for investment. This constitutional rule stands against attempts to use oil revenues for increases in consumptive spending: for the first time in Ecuador's history as an oil-exporter, oil revenues are not being used for consumptive spending. This rule has certainly put pressure on the government to strengthen the country's tax system. Meanwhile, it has also given the state access to the financial means necessary to become a more visible and active development agent.

I have discussed two alternative hypotheses, which explain Ecuador's ability to increase the tax-to-GDP ratio in a time of high resource revenues by increasing government autonomy from economic elites. Accordingly, economic elites have lost their grip on the decision-making process and the government has thus increased its autonomy from them. The return of the state as a tool through which to transform society was a central aim of the Citizens' Revolution: The Correa government and its allies have successfully pushed for this role of the state and have done so against the opposition of the established economic elites who may have been fragmented yet were all tied to the neoliberal, business-led development model.

In accordance with the structural power perspective, increasing public revenues from natural resources have affected business investment power because the available resources have allowed the state to implement its own investment programmes, which have in turn led to a more positive perception of the state and higher levels of support for the government (H2a). As a consequence, the Correa government has been able to implement tax reforms against the opposition of economic elites and to take a more robust stance against tax evasion. I argue that, over the course of the ‘virtuous cycle’, oil revenues have certainly helped to boost the popularity of the Correa government and enable it to pursue investment projects without the consent of the private sector. The Correa government has also undermined the structural power of the economic elites and has enhanced business interests in cooperation with public sector institutions.

However, this alone does not explain the government’s aim to increase tax revenues and its more robust stance against tax evasion. Higher public resource revenues and less structural power of economic elites do not automatically lead to increased revenues and progressive tax reforms. As I have mentioned, previous periods of high resource revenues in Ecuador and other resource-dependent countries have indeed correlated with a decrease in tax revenues. That the opposite has been the case in the context of Ecuador’s Citizens’ Revolution is thus due to a crisis of the economic elites’ instrumental power in combination with the availability of public revenues that have strengthened the government. The analysis has indicated a limited capacity on the part of the government to implement redistributive reforms during the period of low resource revenues that started in the second half of 2014.

According to the instrumental power perspective, the Citizens’ Revolution has caused a process of political and institutional change which has weakened the political power of economic elites, especially as it has undermined established relations to the political system (H2b). It thus became possible to take tax-policy decisions despite the opposition of business representatives and to establish autonomous public institutions along with a merit-based civil service. These developments have allowed the Correa administration to appropriate resource revenues for the public sector, while also increasing the tax-to-GDP ratio. The analysis of the first years of the Correa government shows that the government’s tax policy corresponds to a specific political dynamic of antagonism between the Correa government and established elites. For decades, if not centuries, economic and political elites had been closely intertwined. Thus, the crisis experienced by the established political parties has caused economic elites to lose some of their instrumental power resources. The Correa government successfully framed its more coercive approach towards tax evasion as a fight against corrupted and intertwined political and economic elites. However, the populist antagonism against these elites, justified as it may have been, is not sufficient to sustain a government over a number of election cycles.

The analysis of the sequences of change indicates that political dynamics have played a key role in starting a process driven by two forces: the ideological orientation of the Correa government; and its political autonomy from established political-economic elites. As I have pointed out, the latter’s instrumental power resources were significantly diminished in the first years of the Citizens’ Revolution. This context allowed for important decisions with medium- and long-term impact. The 2008 Constitution has provided a new framework for fiscal policies. Within the state, the executive branch has



gained the exclusive right of initiative on fiscal policy matters. In addition, the state has gained relative autonomy from business interests and become a more coherent actor.

At this point, high public investments, made possible by the increased availability of oil revenues, came into play. Resource revenues have contributed to the significant increase in public investments and thus helped to improve the way the state is perceived. Ecuador has used oil-revenues for massive investments in schools, healthcare facilities, road infrastructure, hydropower projects, and flood-control systems, to name just a few. This has led to the state being perceived in a more positive manner. Despite the importance of oil-revenues, the government discourse puts emphasis on the relation between improved services and tax-payments. The ability to increase tax-pressure is made possible by the government's ability to frame public investments as urgent; its emphasis is on the need for tax revenues to finance a more active state, along with the visibility of improvements.

My analysis has also pointed out contrary tendencies and analysed current difficulties in continuing along the path towards a progressive tax system. The Correa government has taken a more robust approach in order to increase tax collection from political and economic elites. On the other hand, it has seen no alternative to cooperating with the private sector in order to achieve development objectives. Especially in times of decreasing resource revenues, the Correa government has recognised the importance of both foreign and domestic private investments. Thus, the concentration of the means of production and the consequent structural power of the private business sector is itself an impediment for the redistribution of wealth.

Fiscal policies have remained a policy domain disputed between the state and economic elites. The business sector has maintained important sources of instrumental power, not least as a consequence of its structural power. Meanwhile, social movements and trade unions have not developed a coherent fiscal policy agenda that is consistent with their constituencies' interests. In the case presented here – during the present period of economic difficulties – middle-class sectors seem to have joined the country's economic elites in their rejection of taxes.



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## Annex: List of interviewees

- Acosta, A. (2014, 11 November). Personal interview. Economist, Academic Faculty Member of Latin American Faculty of Social Sciences (FLACSO), Presidential Candidate in 2013, President of the Constitutional Assembly 2007-2008. The interview was conducted together with William Sacher. Quito, Ecuador.
- Amoroso, X. (2014, 11 November). Personal interview. National Director of the Tax-Revenue Agency (SRI), Quito, Ecuador.
- Arciniega, J. (2015, 23 March). Personal interview. President of the Trade Union Confederation of Workers of Ecuador (CSE). Quito, Ecuador.
- Aspiazu, R. (2016, 15 June). Personal interview. Executive Director of the Ecuadorian Business Committee (CEE). Quito, Ecuador.
- Balarezo, C. (2015, 6 February). Personal interview. Regional Director for Planning, Information and Public Policies at the National Secretariat of Planning and Development (SENPLADES). Cuenca, Ecuador.
- Bonilla, O. (2015, 23 February). Personal interview. Head of the National Secretariat for Political Action at *Alianza PAIS*. Quito, Ecuador.
- Cadena, E. (2016, 16 June). Personal interview. Executive Director of the Quito Chamber of Commerce. Quito, Ecuador.
- Campaña, J. (2014, 29 October). Personal interview. Lawyer of the Guayaquil based Newspaper *El Universo* and of the former presidents Noboa and Palacio. Guayaquil, Ecuador.
- Campuzano, J. C. (2014, 15 December). Personal Interview. Expert at the SRI-CEF. Quito, Ecuador.
- Carrasco, C. M. (2015, 10 January). Personal interview. Minister of Labor, former National Director of the Tax-Revenue Agency SRI (2007-2014). Quito, Ecuador.
- Carvajal, F. (2014, 22 October). Personal interview. Sociologist at Cuenca University, retired. Cuenca, Ecuador.
- Cisneros, C. (2014, 10 December, and 2016, 7 June). Personal interviews. President of the Chamber of Small and Medium Sized Business of Pichincha. Quito, Ecuador.
- Donoso, P. (2015, 25 February). Personal interview. Member of the National Assembly for the CREO Movement. Quito, Ecuador.
- Flassbeck, H. (2014, 25 August). Interview via Skype. Economist, former German Vice-Minister of Finance, former Director of Macroeconomics and Development at UNCTAD.
- Iturralde, M. D. (2015, 27 February). Personal interview. Executive Director of the Ecuador Chamber of Mining. Quito, Ecuador.
- Iturralde, P. (2014, 14 October). Personal interview. Center for Economic and Social Rights (CDES). Cuenca, Ecuador.
- Kronfle, H. (2014, 28 October). Personal interview. President of the Guayaquil Chamber of Industry and of the Ecuadorian Business Committee. Guayaquil, Ecuador.
- Larriva, O. (2015, 12 January). Personal interview. Member of the National Assembly and Head of the Finance Committee. Cuenca, Ecuador.
- Mancheno, D. (2014, 10 November). Personal interview. Economist at the Pontifical Catholic University. Quito, Ecuador.
- Martinez, A. (2015, 25 February). Personal interview. President of the Chamber of Flower Exporters EXPOFLORES. Quito, Ecuador.
- Moreno, J. (2015, 9 February). Personal interview. Executive Director of the Cuenca Chamber of Commerce. Cuenca, Ecuador.

- Oliva, N. (2015, 12 March). Interview via video-conference. Director of the Centre for Fiscal Studies at Ecuador's Tax-Revenue Agency (CEF-SRI). The interview was conducted together with Marco Peñaloza Bonilla. Cuenca and Quito, Ecuador.
- Páez, P. (2014, 9 October) Personal interview. Superintendent of Market Power Control, former Minister for Economic Coordination. Quito, Ecuador.
- Paz y Miño Cepeda, J. J. (2015, 7 October). Personal interview. Economic Historian and member of the Academic Staff at the Pontifical Catholic University. Quito, Ecuador.
- Pérez, C. (2015, 2 March). Personal interview. President of the Indigenous Federation ECUARUNARI, representing the Sierra Region within the CONAIE, 2nd of March 2015 in Cuenca, Ecuador.
- Pérez, O. (2014, 6 October). Personal interview. Director of the Public Newspaper<sup>47</sup> El Telégrafo. Quito, Ecuador.
- Riofrío, Ch. (2015, 25 February). Personal interview. Executive Director of the Ecuadorian Federation of Forrest and Wood Industry (AIMA). Quito, Ecuador.
- Rivera, P. (2015, 8 January). Personal interview. Minister for Economic Coordination, former Minister of Finance. Quito, Ecuador.
- Robalino, A. (2014, 27 October). Personal interview. Vice-President of the Cuenca Chamber of Industries. Cuenca, Ecuador.
- Romero, F. (2016, 15 June). Personal interview. Member of the National Assembly for the PSC. Quito, Ecuador.
- Sacher, W. (2015, 11 November). Personal interview. Academic staff member of FLACSO. The interview was conducted together with Alberto Acosta. Quito, Ecuador.
- Segarra, R. (2015, 21 January). Personal interview. Trade unionist, workers committee of the public enterprise, ETAPA-EP, and member of the CEOSL trade union Federation. Cuenca, Ecuador.
- Spurrier, W. (2014, 29 October). Personal interview. Economic analyst and director of Grupo Spurrier, member of the Fiscal Observatory (Observatorio Fiscal). Samborondon, Ecuador.
- Stieler, U. (2014, 11 November). Personal interview. Leading staff of the German-Ecuadorian Chamber of Commerce. Quito, Ecuador.
- Villamar, S. L. (2015, 24 February). Personal interview. President of the National Confederation of Peasant, Indigenous, and Black People (FENOCIN). Quito, Ecuador.

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47 Since 15 January 2015, the newspaper has been edited by the public enterprise *El Telegrafo EP*.

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