CEQ POLICY ASSESSMENT: GUATEMALA

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AUGUST 2014

ABSTRACT

In 2010, according to the CEQ analysis for Guatemala, fiscal policy did almost nothing to change inequality and poverty. Recent developments on fiscal policy make things worse. A reduction in social spending, particularly in the flagship CCT program "*Mi Bono Seguro*" will negatively impact poverty and inequality. A reform of the personal income tax will result in lower fiscal revenues. The combined effects of these changes will likely result in an increase of poverty and inequality and reinforce the chronic *status quo* of poverty and inequality in Guatemala.

1 HOW REDISTRIBUTIVE IS FISCAL POLICY IN GUATEMALA?

Guatemala is one of the most unequal countries in Latin America. According to CEDLAS (2013), in 2011 the Gini coefficient was 0.522. Although over the last two decades poverty has declined, the pace has been slow and, even worse, the trend was reversed in the last few years. In 2011 the proportion of poor (measured with the international poverty line of US$4 in purchasing power parity per day) was 62.3 percent, up from 52.6 percent in 2006. According to UNDP (2014), the Human Development Index (HDI) in 2013 (0.628) was below the Latin American and Caribbean average and only above Haiti's. Poverty and low levels of human development are highly correlated with ethnicity: the indigenous population is much poorer and has much lower levels of human development than the nonindigenous group (Cabrera, Lustig and Moran, 2014). Clearly, one of the key factors behind Guatemala's weak performance in terms of equity and social development must be its low per capita GDP growth--a mere 1% annual in the last 20 years--.

Given this bleak situation, how much income redistribution and poverty reduction does Guatemala achieve through its taxation and public spending? Cabrera et al. (2014) applied the Commitment to Equity (CEQ) framework developed by Lustig and Higgins (2013) to the Guatemalan Encuesta Nacional de Ingresos y Gastos Familiares Enigfam 2009-2010 to precisely answer this question. The analysis shows that:

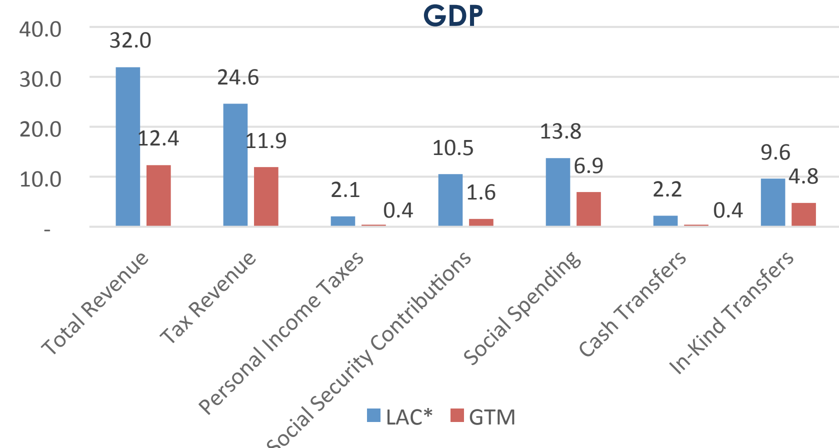
Tax and transfers do little to reduce inequality in Guatemala. After direct taxes and cash transfers, the Gini coefficient declines by only 0.005 and the headcount ratio ($2.5 PPP poverty line) by 1.3 percentage points. Even worse, after consumption taxes are taken into account, poverty is higher than before taxes and transfers: that is, fiscal policy leaves part of the poor population worse off in cash terms. This puts Guatemala among the low redistributive performers. When transfers in-kind such as public education and health are also counted, the reduction in inequality is a bit higher but still much smaller than other countries in Latin America. Guatemala's redistribution compares unfavorably to that of other Latin American countries with similar inequality (Brazil) or GDP per capita (Bolivia and El Salvador) In fact, in Brazil all taxes and transfers combined reduce the Gini coefficient by 14 percentage points (Higgins and Pereira, 2014) whereas in Guatemala the reduction is merely 2.4 percentage points.

This low contribution of the tax/benefit system to inequality reduction in Guatemala is due mainly to structural features of the tax system. The tax burden continues to be one of the lowest in LAC in spite of efforts by successive governments to introduce revenue rising taxes reforms since the Peace Accords were signed in 1996.[1] The contribution of direct taxes to fiscal revenues is also dramatically low, with personal income taxes representing 0.4 percent of GDP (Figure 1). On the expenditure side, constitutional rigidities make it extremely difficult to increase social spending. Few resources are allocated to direct and in-kind transfers targeted to the most disadvantaged social groups, namely, the rural and indigenous populations.

Although direct taxes are somewhat equalizing, low collection of these taxes limit their potential contribution to improve income distribution. On the other hand, the value added tax (VAT), which represents almost half of total tax revenues, is regressive, so income inequality after both direct and indirect taxes and direct transfers is roughly the same as market income inequality. Even worse, as stated, consumption taxes more than offset the benefits to the poor of quite progressive cash transfers leaving post-fiscal (after all taxes and cash transfers) poverty at a same level than market income poverty.

Even though the government has recently introduced two flagship social transfer programs, namely, a noncontributory pension program (*Programa del Adulto Mayor*, 2006) and a conditional cash transfer program (*Mi Familia Progresa*, 2008), direct cash transfers to GDP are a mere 0.5 percent, also among the lowest in Latin America. Our results show that the conditional cash transfer program *Mi Familia Progresa*, in 2010 was pro-poor and pro-indigenous, but its scale was too small to make a significant difference. Namely, the size of the transfer and the coverage of the target population are low. Education spending is not pro-poor or pro-indigenous enough. And health spending reaches only a fraction of the poor. Inequality of opportunity (i.e., inequality due to circumstances) is not reduced at all by fiscal interventions.

FIGURE 1. GUATEMALA AND LAC: REVENUE AND SPENDING CATEGORIES (CIRCA 2009); % OF GDP



Source: CEQ Standard Indicators and Cabrera, Lustig & Moran (Forthcoming)

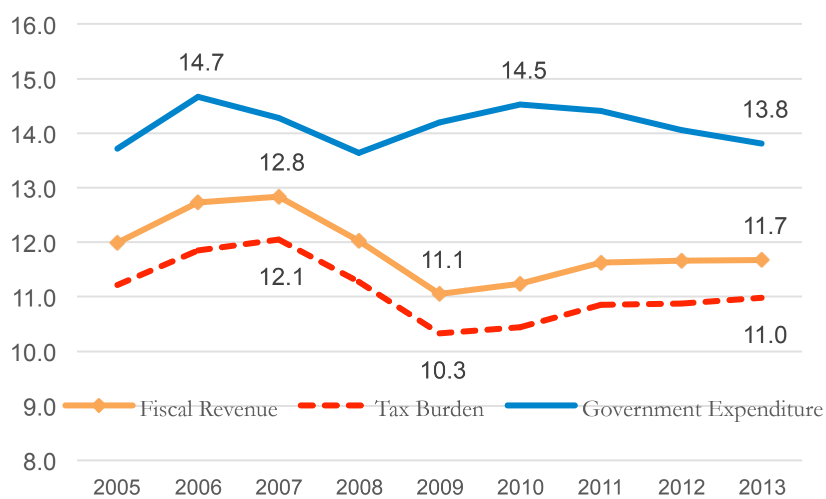
2 WHAT HAS CHANGED SINCE 2010

Our analyses of the redistributive effects of fiscal policy were made for the year of 2010. What has happened since? Have there been changes that would result in an increase the income redistribution and poverty reduction effects of fiscal policy? Quite the contrary. Because tax revenues have been insufficient to cover government spending and have been growing at a slow rate (despite fiscal reforms introduced in 2002), the tax burden (revenues as a percentage of GDP) remained at about 11 percent in the last three years. In order to offset this weakness on the revenue side, the Guatemalan government has reduced public investment and spending on some social programs. As a result, the fiscal deficit has declined and public debt has stabilized at around 25 percent of GDP. Instead of strengthening the revenue base through a more aggressive direct tax collection on Guatemala's wealthy

[1] After a 36-year-long civil war, the Peace Accords established as a goal to increase the tax burden from 8 to 12 as a percentage of GDP from 1996 to 2000. Specifically, the Agreement on Social and Economic Aspects and Agrarian Situation identified several commitments to fiscal policy and it gave rise to the so-called Fiscal Pact in Guatemala. The unfortunate Fiscal Pact process had its formal beginning with the statement of rescheduling of compliance with the tax goal of the Peace Accords in October 1998. It intended to raise taxes from 8 to 12 percent in 2002 and to take short-term actions in order to guarantee the gradual growth of the tax burden. However, this agreement has not been reached yet, even, after 15 years of signed.

(on income and property), the government reduced the tax burden on the rich and increased the tax burden on the middle class. Furthermore, spending on targeted anti-poverty programs was cut.

FIGURE 2. PUBLIC EXPENDITURE, FISCAL REVENUE AND TAX BURDEN (2005-2012); % OF GDP



Source: Ministry of Finance

There have been two main changes in the tax/benefit system in Guatemala since the year of our CEQ Assessment. First, in February and March of 2012 the Guatemalan Congress approved two bills intended to improve fiscal revenues. These are the "Ley Antievasión II" (Decree 4-2012), and the "Ley de Actualización Tributaria" (Decree 10-2012). They include extensive amendments to the tax code ("Código Tributario") and other tax laws of which, according to Alfaro y Quiñones (2012) the most notorious and substantial affect the VAT law, the tobacco tax law, and the income tax law. A completely new income tax law entered into force on January 1st, 2013.[2]

One of the changes introduced by the new government targets the payroll income tax, increasing the level of exempt income, reducing rates and eliminating deductible expenses and VAT credits. We believe that the net effect of these modifications might be a tax relief for high-income taxpayers and a slight tax increase for individuals in the middle-class. The government removed a twofold increase of the Vehicle Traffic Registration Tax that could have positively impacted income distribution from the original reforms. Despite the overhaul of the tax code, Guatemala's tax burden still remains one of the lowest in Latin America.

The second main change has been an austerity-driven contention of government expenditures, including the flagship CCT program "*Mi Familia Progresa*"[3]. The financial resources allocated to this program decreased from 1.1 billions quetzals in 2010 to only 0.4 billion in 2013. In spite of the lack of data, we think that lower resources meant that the number of transfer recipients also went down in 2013. This reduction may have had a substantially negative impact on poverty and extreme poverty, taking into account that the CEQ findings suggest that direct transfers reduced poverty by 1.6 percentage points.

Overall, social expenditure (as a percentage of GDP) has declined in the last three years. In-kind transfers like education declined from 2.8 to 2.4% of GDP between 2010 and 2013. A very concerning indicator is that net school enrollment in primary school declined from 98.7 percent in 2009 to 89.1 percent in 2012. The budget of the health Ministry has increased, but it is still awfully low: only to 1.2% of GDP. This small increase is unlikely to have any significant effect on the coverage of public health services.

Under the direction of Ludovico Feoli and Nora Lustig, the CEQ Policy Assessments series was created to highlight the key policy implications of the CEQ Assessments and, in light of them, evaluate the likely impact of observed fiscal policy changes on inequality and poverty. Led by Nora Lustig since 2008, the Commitment to Equity (CEQ) project is an initiative of the Center for Inter-American Policy and the Department of Economics, Tulane University, the Center for Global Development and the Inter-American Dialogue.

[2] Alfaro and Quiñones (2012) and Cabrera and Schneider (2013) describe in detail the 2012 modifications of the tax code.

[3] This program was renamed as "Mi Bono Seguro" in 2012.

TABLE 1. SUMMARY OF PROBABLE EFFECTS OF FISCAL POLICY MEASURES

Concept	(% of GDP)		Income Measure	Likely effect on Inequality	Likely effect on moderate poverty	Likely effect on extreme poverty
	2010	2013				
Personal Income Tax – Wage Earners reform	0.16%	0.13%	Net Income	+	0	0
Personal Income Tax - Non wage earners	0.19%	0.14%	Net Income	0	0	0
Downsizing of CCT	0.34%	0.09%	Disposable	+	+	++
Reduction in Education Expenditure	2.75%	2.42%	Final Income	++	[redacted]	[redacted]
Stagnation of Health Expenditure	1.08%	1.17%	Final Income	0	[redacted]	[redacted]

Source: own estimates.

In Table 1 we illustrate the potential effects of fiscal policy changes in the last three years since the CEQ analysis for Guatemala was elaborated. The likely effects on inequality, moderate poverty and extreme poverty discussed here are based on the effects observed in 2010 CEQ report. The second and third columns of Table 1 show the main variables under study as a percentage of GDP. The difference between those two columns represents the change observed in the variable of interest. The fourth column shows the CEQ income measure affected by the changes and then, the table shows the likely effect on inequality and poverty.

The findings shown in Table 1 can be explained as follows: (i) we may expect a small increase of income inequality from the modification of the labor income tax because the taxpayers affected are in the tenth decile, which implies that this group of relatively wealthier individuals will pay less than before due to the drop of the tax rate from 31 to 7 percent; (ii) CCTs are concentrated in households living in extreme poverty and to a lesser extent in households living in moderate poverty, while almost nothing is transferred to non-poor households, and therefore, this change will generate a larger increase in extreme poverty and income inequality; (iii) the drop in education spending will impact lower income households and hence, will negatively affect inequality; (iv) the increase in health spending is insignificant and given that spending in this area is hardly progressive, we believe that it will not impact inequality. In short, Table 1 shows that recent developments of fiscal policy in Guatemala will negatively affect poverty and inequality.

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