

GUATEMALA

USAID ASSISTANCE IN FISCAL REFORM TO THE GOVERNMENT OF GUATEMALA

I. PROJECT DATA

Level of Funding: \$2.268 million (1996-2001)
\$742,000 (2001-2004)

Periods of Assistance: 1996-2001
2001-2004

Type of Assistance:

1. Technical assistance
2. Training
3. Materials and Equipment

Areas of Assistance:

1. Institutional and Organizational Development
2. Tax Administration Operational Support
3. Tax Policy Analysis

Main Counterparts:

1. Superintendency for Tax Administration (SAT)
2. Ministry of Finance
3. Fiscal Pact Tracking Commission (CSPF)

II. THE PROJECT: BACKGROUND, PRINCIPAL RESULTS AND IMPACT

Introduction

Over several decades preceding the mid-1990s, the Government of Guatemala and its Ministry of Finance (MOF) received large amounts of international donor technical assistance (TA) funding aimed at improving tax administration deficiencies. This donor TA included significant quantities of Inter-American Development Bank (IDB) financing (beginning in 1984), a World Bank Structural Adjustment Loan (SAL) from 1992 to 1995 that contained numerous tax policy and tax administration conditions, GTZ (Germany) grant TA from 1989 to 1991, UNDP/UNCTAD grant monies for the mechanization of customs entry processes, and USAID project grants (1989-94).

Although these TA efforts did leave some positive elements (including in the decentralization and generation of information systems/databases that are essential to tax collection efforts), overall tax administration remained weak. Significant beginnings of major tax reforms fell away with changes in political leadership. Moreover, the bottom-line as measured by Guatemala's tax ratio (tax revenues as a percentage of GDP) showed little or no improvement, having averaged a mere 7.8% between 1990 and 1997; it had fallen as low as 6.8% in 1994. This very deficient tax revenue performance is evident from the ratios presented in Table 1.

With the signing of the Peace Accords in late 1996 a goal of raising the tax ratio to 12% by 2000 (a date later pushed back to 2002 but never reached) was set; the revenue was needed in order to finance planned increases in social spending. Thus a more effective approach to tax administration and collection was required. At the beginning of 1997 the Government of Guatemala took the decision to establish a semi-autonomous revenue administration (SARA) to collect tax revenues. Throughout the rest of 1997 and during 1998 (with USAID, World Bank, and assorted donor assistance), measures were taken to separate tax administration functions from the traditional line structures within the MOF. Using examples from other countries (especially Peru), in 1998 (under Decree 1-98) the Guatemalan legislature established the Superintendencia de Administración Tributaria (SAT). The year 1998 was one of transition, and in 1999 the SAT became fully operational. USAID/Guatemala grant-financed technical assistance played a key role both during the early formative years of the SAT and into its first several operational years; its influence continues to have significant impact on tax administration and related policy, through mid-2004.

A. Background and Environment for Tax Reform (1996-2000)

Via a contract with a Guatemalan consulting firm, USAID/Guatemala financed the establishment of a Project Coordinating Unit within the MOF to take the requisite steps to establish the SAT and to negotiate a \$28 million loan from the World Bank with the express intent of creating an operational organization. This contract provided both national and international consultants in carrying out the following activities:

- Design of the SAT's Organic Law, which was approved by the Guatemalan Congress on January 12, 1998.
- Preparation of the SAT's 1998 and 1999 budgets.
- Design and approval of the SAT's Internal Regulations and personnel regime.
- Development of an Action Plan detailing steps to be taken for operations.
- Preparation of a four-year budget for the activities to be financed under the forthcoming World Bank loan.
- Designs for the different tax administration modules (e.g., collections, IT systems, auditing, and finance).
- Training programs.

- Numerous international agreements with other donors to offer additional TA.
- Specifications for and acquisition of equipment (e.g., computers, software, furniture).
- Selection, recruitment, and contracting of personnel under a contract with an international consulting firm specialized in the area.
- Study tours abroad to observe best practices in Chile, Colombia, and Mexico.

In sum, between October 1998 and September 2000, USAID/Guatemala grant funding financed the 51 short-term consultants, 21 long-term consultants, hardware, and the administrative aid of four national and three international consulting firms. USAID support during the SAT's formative period is recognized as having been extremely significant.

B. Outcomes and Impacts in the Project's Principal Areas of Assistance (2001-2004)

1. Background Research in Support of Tax Reform of Tax Administration

Based on the success of USAID's technical assistance for fiscal reform during the SAT's formative years, from late 2001 through early 2004 USAID contracted with a U.S.-based consulting firm to carry out a series of studies aimed at improving the SAT's tax administrative capabilities and the MOF's tax policy decisions. The studies were specifically requested by the Minister of Finance (who by law also presides over the SAT's Board of Directors). They were designed to inform plans for meeting some of the goals specified in the May 25, 2000 Fiscal Pact, an agreement that represented a turning point in Guatemala's fiscal history. The Pact was the end-product of discussions initiated in late 1998 that officially recognized the large socio-economic gaps existent in Guatemalan society and the urgent need to reduce them by increasing public spending on education, health, and infrastructure. It represented a consensus viewpoint of leaders from all sectors of Guatemalan society that additional public resources had to be raised via the tax system.

Under the new contract, a USAID-funded project labeled "Promoting a Sound and Simple Tax System" did the bulk of its work in 2001 and 2002. The studies resulting from this work were:

- a. "*Aplicación de Mejores Prácticas Internacionales al Desempeño de la Administración Tributaria de Guatemala: Un Estudio de Benchmarking.*" ["Application of Best International Practices to Guatemala's Tax Administration: A Benchmarking Study"]. This study provided the SAT with numerous international and Central American benchmarks against which it was able to judge its own performance covering a large variety of functional areas.

- b. “*El Gasto Tributario en Guatemala.*” [“Tax Expenditures in Guatemala”]. This study generated the first publicly circulated estimates of the cost of tax expenditures as measured by foregone revenues.
- c. “*Guatemala: Los Costos Administrativos de la Tributación y de Impuestos de Bajo Rendimiento.*” [“Guatemala: The Administrative Costs of Taxation and of Low-Yield Taxes”]. This study provided the SAT with a methodology for measuring its own administrative costs by tax and by functional expenditure category. It additionally identified several taxes whose administrative costs represented a relatively high proportion of their gross collections.
- d. “*Propuesta para Establecer dentro de la SAT de Guatemala Entidades de Investigación de Delitos Tributarios y de Investigación de Corrupción.*” [“A Proposal to Establish in the SAT Units to Investigate Tax Fraud and Internal Corruption”]. This proposal provided the SAT with specific guidelines as to how to establish units to reduce taxpayer fraud and internal corruption within the SAT itself.
- e. “*Guatemala: La Incidencia del Sistema Tributario en el Año 2001.*” [“The Incidence of Guatemala’s Tax System in 2001”]. This study estimated Guatemala’s tax burden by household income decile for all major taxes. By linking the study’s conclusions to proposed tax policy changes, equity considerations can be taken into account.

2. Constituency Building for Reform of Tax Administration

During the second half of 2003 the results of these studies were disseminated in a series of four forums financed by USAID/Guatemala in collaboration with a Guatemalan think-tank, the Centro de Investigaciones Económicas Nacionales (CIEN). The invitees (numbering over 150 per forum from the private and public sectors) to each presentation were specifically selected based on their interest in fiscal matters. The fora were initiated by the Fiscal Pact’s Tracking Commission (Comisión de Seguimiento del Pacto Fiscal—CSPF), a body that had been set up in 2000 to follow up and track the progress made toward fulfilling the many facets of the May 2000 Fiscal Pact. This Commission had been rather dormant during 2002 and early 2003, and the Commission’s Director deftly used the presentations to renew interest in the Commission’s work. With the change in the national government in January 2004, the Commission again became a key player in the formulation of Guatemala’s fiscal policy.

3. Beginnings of Improvement in Tax Share of GDP

The technical assistance provided during the SAT’s formative years undoubtedly contributed to its initial establishment and operations. In an April 2004 interview, one of the principal Guatemalan consultants between 1996 and 2001 opined that the grants

provided by USAID during the SAT's formative years had been "key" to the SAT's initial establishment. His conviction is that "without USAID's initial assistance the SAT's start-up would have been impossible." This by itself is a significant achievement in a society historically averse to paying any taxes at all. By the end of 2003 the SAT had not yet reached its original goal of collecting 12% of Guatemala's GDP. Nevertheless, post-1998 tax performance in terms of both tax revenues and administrative efficiency did improve until late 2002, when internal problems within the SAT led to diminished efficiencies. These problems were in no way connected to USAID assistance. The SAT's increased productivity from 1998 through 2002 (and the drop in 2003) is reflected in the data found in Tables 1 and 2.

Table 1 demonstrates that, whereas Guatemala's tax ratio (all tax revenues as a proportion of GDP) averaged under 8% from 1990 to 1998, from 1999 to 2003 the average weighed in at nearly 10%. While even the ratios for the latest years remain low by developing country standards, they do represent substantial rises over the pre-SAT period.

TABLE 1

GUATEMALA: TAX RATIOS, 1990-2003

Year	All Taxes ^(a)	Income	VAT ^(b)	Excises	Import Duties	Other Taxes
1990	6.87	1.48	2.30	0.73	1.54	0.82
1991	7.33	2.10	2.16	0.86	1.39	0.82
1992	8.31	1.78	2.64	1.07	2.11	0.71
1993	7.82	1.85	2.61	1.09	1.75	0.52
1994	6.77	1.13	2.52	1.02	1.58	0.52
1995	7.72	1.60	2.80	1.04	1.88	0.40
1996	8.53	2.08	3.70	0.95	1.55	0.25
1997	8.78	2.08	3.62	1.18	1.40	0.50
1998	8.74	1.91	3.68	1.36	1.36	0.43
1999	9.35	2.14	4.08	1.35	1.34	0.44
2000	9.46	2.20	4.18	1.20	1.21	0.67
2001	9.67	2.34	4.24	1.28	1.20	0.61
2002	10.55	2.79	4.68	1.19	1.24	0.65
2003	10.28	2.68	4.73	1.31	1.21	0.35

(a) Net of social security, refunds, and municipal taxes.

(b) Net of refunds.

Sources: Developed from data provided by the Ministry of Finance and the SAT.

In Guatemala, the value-added tax (VAT) generates approximately 45% of total tax revenue (the 2000-2003 average was 44.6%), and its efficiency and compliance rates are therefore critical to its overall tax revenue performance. The figures in Table 2 (last column) show compliance improvements (over the pre-SAT era) in the SAT's first operational years, but slippages after 2000. Only in part were these due to internal implementation deficiencies, as external political interference played a highly significant role.

TABLE 2

VALUE-ADDED TAX COMPLIANCE RATE

Year	(1) Nominal VAT Rate	(2) Household & Government Consumption As % GDP(a)	(3) Net VAT Collections as % GDP	(4) Potential VAT Collections as % GDP(b)	(5) VAT Compliance Rate(c)
1990	7.0	90.38	2.30	6.33	36.33
1991	7.0	89.65	2.16	6.28	34.39
1992	7.0	91.47	2.64	6.40	41.25
1993	7.0	90.77	2.61	6.35	41.10
1994	7.0	91.55	2.52	6.41	39.31
1995	7.0	91.12	2.80	6.38	43.89
1996	10.0	92.09	3.70	9.22	40.13
1997	10.0	91.96	3.62	9.20	39.35
1998	10.0	90.69	3.68	9.07	40.57
1999	10.0	91.00	4.08	9.10	44.84
2000	10.0	90.92	4.18	9.09	45.98
2001	10.82	92.40	4.24	10.00	42.40
2002	12.0	93.31	4.68	11.20	41.79
2003	12.0	94.47	4.73	11.34	41.71

(a) From national accounts.

(b) Nominal VAT rate multiplied by column (2).

(c) Actual collections from column (3) divided by potential collections from column (4).

Sources: Developed from data provided by the Bank of Guatemala, Ministry of Finance, and SAT.

USAID/Guatemala's TA from 2001 to 2004, while lower in dollar amounts than that offered in the formative years, made several significant contributions to tax administration policy efforts. The benchmarking study (completed in December 2001), with its innovative and transparent methodology, has been put to constant use by the SAT to gauge its progress toward attaining international standards. The ultimate proof of this is that, at the behest of the new SAT administration (which initiated its tenure in January 2004), most of the same team that carried out the original study returned to Guatemala in April-May 2004 to update the benchmarks and target those areas where improvements

should be made; this latter TA was also funded by USAID/Guatemala. Several persons from this team also collaborated with the SAT and the Ministry of Finance to brainstorm potential revenue-raising measures in view of 2004 revenue shortfalls and in carrying out a public expenditure incidence analysis.

The study on tax expenditures led to the SAT publicly circulating its own estimates of tax expenditures in late 2003; the SAT will annually update this study. Moreover, it provided recommendations as to measures to adopt to increase revenues. The author of both the tax expenditure and tax incidence studies was invited (in August 2003) to give a presentation of his findings at one of the aforementioned fora. To encourage discussion and increase knowledge of Guatemala's tax system, all the studies were later placed on a CD by Guatemala's CSPF, and were also made available on the Ministry of Finance's website.

III. FACTORS OF SUCCESS

1. Guatemalan Leadership in Selecting Areas for Reform. There is little doubt that the principal element of success is that USAID responded to distinct needs expressed by the Guatemalans themselves; i.e., they were not imposed by an international organization (e.g., the IMF). While this statement applies more strongly to the grants provided for the SAT's formative stages, it also applies to the second stage. This is because the second stage studies were called for in the May 2000 Fiscal Pact, and designating neutral (i.e., non-Guatemalan) consultants to carry them out greatly added to their acceptance.

2. USAID Agility in Responding to Political Circumstances. While undoubtedly successful, USAID's assistance to Guatemala (the bulk of which was channeled to the SAT) was not an unqualified success. This is not a negative reflection on USAID itself. Rather, it reflects the course of Guatemalan politics, the actions of the national government that was in power during the years 2000-2003, and its direct and deleterious interference in the SAT's internal administrative processes. This interference became especially prevalent after mid-2002, when a new SAT Superintendent began to pervert the SAT's autonomy regarding personnel, procurement, and financial systems. To USAID's credit, it essentially withdrew most of its direct assistance to the SAT during this period. Instead, it targeted modest amounts of assistance to the CSPF. With the January 2004 advent of a reformed-minded government and the appointment of a new SAT Superintendent, USAID began to funnel assistance to the SAT and the CSPF (since renamed the Comisión Técnica del Pacto Fiscal—CTPF). As a footnote to the SAT's regression during 2003, in January 2004 its Superintendent fled the country, is being sought for corruption by Interpol, and a reward has been posted for his capture.

3. Continuing Applicability of Previously Completed Analysis of Reform Needs. There remains much to be done within the SAT to retake its upward 1998-2001 path. As of mid-2004, there are strong indications that Guatemala's reform-minded government (that assumed office in January 2004), the SAT, and the Ministry of Finance will take the steps

required to place the SAT back on its initially successful track. Corrupt employees are being identified and weeded out. As part and parcel of this reform process, the SAT will do well to implement the USAID-funded study that designed internal anti-corruption and tax fraud units. Moreover, the updated (2004) benchmarking study will provide the SAT with indicators of those areas that it should strengthen.