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Fiscal Policy, Inequality, and the Ethnic Divide in Guatemala

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Summary. — Guatemala is among the most unequal countries in Latin America. It also has the highest incidence of poverty, especially for the indigenous population. In this paper we do a fiscal incidence analysis using the 2009–10 household survey ENIGFAM. The results show that fiscal policy does very little to reduce inequality and poverty overall and along ethnic lines. Persistently low tax revenues are the main limiting factor. Even worse, tax revenues are not only low but also regressive and burdensome on the poor. Consumption taxes are high enough to offset the benefits of cash transfers: poverty after taxes and cash transfers is higher than market income poverty.
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Key words — inequality, poverty, ethnic divide, fiscal incidence, taxes and social spending, Guatemala

1. INTRODUCTION

Guatemala is a lower middle-income country with one of the most unequal distributions of income and one of the highest poverty rates in Latin America. In 2011, while the (unweighted) average Gini coefficient for Latin America was 0.487, the Gini for Guatemala was equal to 0.522 (Figure 1). Although over the last two decades poverty has declined, the pace was slow. [1] Moreover, since the mid-2000s, poverty rose: in 2011, the headcount ratio was 40.7%, up from 33.4% in 2006. [2] According to UNDP (2014), the Human Development Index in 2013 (0.628) was far below the Latin American and Caribbean average (0.74) and only above those of Haiti, Honduras, and Nicaragua. Guatemala had the lowest level in the Human Opportunity Index from a sample of 19 countries in Latin America (De Barros, Ferreira, Molinas, & Saavedra, 2009, p. 10). Sahn and Younger (2006) found that Guatemala had the most unequal distribution of education and health of a sample of six Latin American countries.

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. With an incidence of poverty of 58.6%, an indigenous individual is more than twice as likely of being poor than a nonindigenous one. [3] Although the indigenous population represents around 40% of the total population, 60% of the extreme poor are indigenous. [4] Poor Guatemalan families are predominantly indigenous and have experienced centuries of exploitation and exclusion, with weak influence over local and national decision-making (de Ferranti *et al.*, 2003). The poverty gap between indigenous and nonindigenous individuals is highly correlated with the disparities in educational attainment by ethnicity. [5]

The profound ethnic divide was a fundamental cause of a long and protracted civil war that plagued Guatemala for 36 years. In 1996 – after more than 200,000 deaths and "disappearances" and more than half a million displaced individuals – the Guatemalan Peace Accords were signed (Archdiocese of Guatemala, 1999; Historical Clarification Commission, 1999). The Peace Accords committed the country to raise the tax burden by 50% – that is, to reach 13.2 of GDP – during 1996–2002, and to gradually increase the tax burden further subsequently. Twenty years later, not even the initial goal has been reached. In spite of the repeated attempts to introduce revenue raising tax reforms, the tax burden continues to be one of the lowest in Latin America. While in Latin America the average tax burden (including social security contributions) was around 24.7% in 2013, in Guatemala it was only 13.0% (ECLAC, 2015). In particular, personal income taxes were a meager 0.4% of GDP in Guatemala while the average for Latin America equaled 2.5% in 2013.

Fiscal policy in Guatemala has been mainly concerned with macroeconomic stability: fiscal deficits and public indebtedness have been relatively and consistently low (about 2.5% of GDP and around 24 of GDP from 2010 to 2014, respectively, according to data of Ministry of Finance of Guatemala). Social equity concerns, however, have fallen between the cracks. While there have been occasional attempts to expand social spending to benefit the most disadvantaged groups – i.e., the rural and indigenous population, [6] resources devoted to this end remain low. Social spending (including contributory pensions) is around 7.4 of GDP in Guatemala – one of the lowest in Latin America (ECLAC, 2015). With such low levels of social spending and a high reliance on indirect taxes, tax-based redistribution in Guatemala is bound to be limited.

In addition to low revenues, the government faces a series of rigidities embedded in the Constitution or in its interpretation given by the justice system. These constraints make it very difficult to increase social spending or to change its composition (Barreix, Bes, & Roca, 2009, p. 33). According to the Ministry of Finance, in 2014, about 88% of fiscal revenues were pre-committed to specific spending lines such as the public sector wage bill, debt service, municipalities, the justice system,

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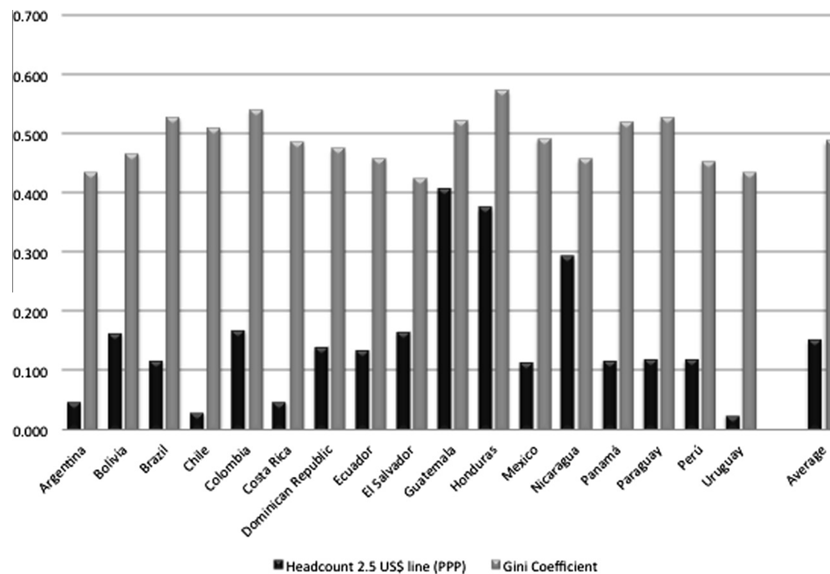

Figure 1. *Poverty and inequality in some Latin America countries. Source: ECLAC (2015). Poverty is expressed as a fraction of total population.*

tertiary education, support to sports (Alianza Técnica de Apoyo al Legislativo, 2014).[7]

Among the attempts to help the poor, escape the vicious cycle of poverty, Guatemala has been no exception to the pervasive trend in Latin America of incorporating targeted cash transfers programs to the social policy menu designed to reduce poverty and social exclusion.[8] In 2006, the government launched the noncontributory pension known as the Economic Assistance Program for the Elderly.[9] Designed to provide a minimum living standard for the elderly poor population (over 65 years old) who are not beneficiaries of contributory pensions. Eligible individuals receive a transfer of close to $50 dollars per month. By 2010, the program had around 103,000 beneficiaries or, 18.6% of target population (Acción Ciudadana, 2013). In 2010, spending on this program represented 0.1% of GDP.

In 2008, the government launched the conditional cash transfer program "My family progresses"[10] (MIFAPRO) as part of an attempt to tackle social inequities more forcefully. The main objective of MIFAPRO is to increase the human capital of younger generations in order to break the intergenerational transmission of poverty. The program provides two cash transfers, both targeted to poor women. A monthly health and nutrition cash transfer of approximately $19 current dollars in 2010 is given to mothers of children under the age of six, to pregnant women and breast-feeding mothers, under the condition that they attend health centers to receive a basic package of nutritional and preventive maternal-child health care services. An education grant of the same magnitude is given to poor families with at least one child between 6 and 15 years old attending primary public school or preschool. Families can receive both transfers (approximately $38 dollars). Spending on this program equaled 0.4% of GDP in 2010. By 2011, the number of children from age 0 to 15 years old that benefited from this program equaled about 2,420,000 (living in 887,972 beneficiary households) (Secretaría de Planificación y Programación de la Presidencia, 2012). A small program to start with, spending on this program has fallen since 2010, reducing its ability to make an impact on the extreme poor. By 2013, the budget for MIFAPRO has been gradually reduced to only 0.1% of GDP.

Given the constraints imposed by a limited budget and a hand-tying legal framework, how much redistribution, poverty reduction, and reduction of the welfare gap between the indigenous and nonindigenous population is accomplished through fiscal policy? In particular, has the introduction of targeted cash transfers made a difference? If the answer is affirmative, how significant that difference is? We respond to these questions by applying a standard fiscal incidence analysis to examine the impact of taxes and social spending on income inequality and poverty for the population as a whole and by ethnicity. In particular, we analyze the impact of fiscal policy on the income gap between the indigenous and nonindigenous population and examine how equitable the use of public health and education services is across income categories and between groups. The fiscal incidence method we apply here is described in detail in Lustig and Higgins (2013) and was applied to several countries in (Lustig, Pessino, & Scott, 2014). Our incidence analysis uses the National Survey of Family Income and Expenditures 2009–2010 (or, ENIGFAM, for its Spanish acronym).

Known in the literature as the "accounting approach" because it ignores behavioral responses and general equilibrium effects, incidence analysis of public spending and taxation is designed to respond to the question of who benefits from government transfers and who ultimately bears the burden of taxes in the economy. With a long tradition in applied public finance, tax, and benefit incidence analysis is an efficient instrument to evaluate whether fiscal policy has the desired effect on poverty and inequality (Martínez-Vazquez, 2008; McKay, 2002; Musgrave, 1959; Pechman, 1985). The increasing availability of household surveys containing sufficient information to assess the effects of fiscal policy on incomes and their distribution has increased considerably the number of empirical studies in this area. A literature review by Chu, Davoodi, and Gupta (2000) covering 55 developing country studies, for example, finds that while public spending in cash transfers, education and health are progressive (i.e., equalizing), they were not sufficiently targeted to the poor especially in sub-Saharan Africa. Similarly, Lustig *et al.* (2014) find that the combined effect of social spending and taxation is equalizing but not always poverty reducing for six Latin American countries.[11]

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