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President Jimmy Morales Forced to Make a U-Turn on Fiscal Reform Proposal for Guatemala

by Louisa Reynolds
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Reneging on an election campaign pledge not to raise taxes, Guatemalan President Jimmy Morales put forward a fiscal reform proposal that would have increased personal and business taxes as well as the tax rates on vehicle and jet fuel, cement sales, and mining royalties. However, in the face of widespread opposition from the business sector as well as a number of civil society organizations and think tanks, he was forced to make an embarrassing U-turn and re-draft the project (NotiCen, Nov. 5, 2015, March 17, 2016, and June 30, 2016).

Lawmakers began to debate the fiscal reform plan on Aug. 17, with a government-imposed 60-day deadline to approve it. The Ministry of Public Finances estimates that the overall impact on tax revenue from the proposed measures would have amounted to a substantial 5.9 billion quetzales (US$780 million) in 2017, around 2.3% of forecast GDP.

The government argues that major companies with high earnings need to contribute more to support poverty reduction and improve public services. Guatemala has one of the lowest tax revenue collection ratios in Latin America, at 10.2% of GDP in 2015.

The two main planks of the fiscal reforms, which account for around 94% of the total increase in the tax take, involved hikes on company and individual earnings, and vehicle fuel tax increases. The impuesto sobre la renta (the tax on net earnings for large businesses) would have increased from 25% to 29%, and tax for small- and medium-sized businesses, which is calculated on gross earnings, would rise from 7% to 12%. The basic income tax rate for workers would rise from 5% to 7%. Better-paid individuals would have been taxed at an incremental rate, rising from 15% to a top rate of 29% on earnings over US$38,000 per year.

Fuel tax

The impuesto sobre la distribución del petróleo (the tax on vehicle fuels) has not increased since 2003. The reform envisaged a 3 quetzales (US$0.40) increase per gallon across the board for all types of fuels. This increase would have generated US$369.3 million worth of additional revenue in 2017 (48% of the total tax increases), according to government projections. A tax on cement sales would have risen by 350%, to 500 quetzales (US$66.20) on each 42.5-kg bag. Mining royalties would have increased in a band linked to international prices, from 1% to 10% for precious metals, and from 1% to 3% for base metals. These last two measures would have raised only modest sums and are not expected to be controversial.

Tax increases are long overdue, but the government faced a fight over some aspects of its proposals. In particular, the increase on the tax on diesel fuel proved to be highly contentious, owing to its impact on agriculture and secondarily, on transport and the cost of most businesses. Hours after the local media published details of President Morales’ proposal, Guatemalans vented their anger on Twitter and other social media platforms using the hashtag #NiCementoNiGasolina (No to the increase on fuel and cement).
Opponents of the reform say that the government is failing to rein in spending, putting an unnecessary emphasis on tax increases. However, this complaint is not supported by fiscal data, which shows spending in the first half of 2016 falling by 8.2% year on year. Business leaders also complain that there has been insufficient consultation on the measures and warn of dire consequences for some sectors of the economy. Rather than increasing taxes, the private sector advocates broadening the tax base and imposing penalties on the under-employed in order to force them to join the formal economy.

Morales makes a U-turn

In the face of opposition from civil society organizations, the business lobby, as well as academics, President Morales was forced to make an embarrassing U-turn 10 days after the debate on the fiscal reform plan began, when he asked the president of Congress, Mario Taracena, to return the proposal.

“We have listened to civil society regarding the need to strengthen the reform, which should include measures to make public spending more transparent, set limits on public spending and take into account macroeconomic principles,” said Minister of Public Finance Julio Héctor Estrada. He added that a new proposal would be submitted to Congress in September but didn’t set a specific date.

Estrada also said that the concept of a “multi-annual budget” could be added to the proposal, as well as other tax hikes that had not been previously considered, such as higher tax rates on the sale of firearms, alcoholic beverages, and cigarettes, as part of an effort to boost tax revenue and improve public health.

Despite the overall unpopularity of President Morales’ tax reform proposal, some analysts have acknowledged that boosting tax revenue is the only way to fund much needed improvements in public education and health care.

“I’m not a fan of Jimmy Morales’ administration due to its many inconsistencies, but this time he’s right. Guatemala cannot have good quality public services and build a strong state if it doesn’t increase taxes,” wrote Martín Rodríguez Pellecer, director of Nómada, an investigative journalism website.

In February 2012, Morales’ predecessor, Otto Pérez Molina (2012-2015) (NotiCen, Sept. 13, 2012, Sept. 4, 2014, and Dec. 11, 2014), put forward a tax reform proposal that was swiftly approved by Congress but was declared unconstitutional by the country’s highest court, the Corte de Constitucionalidad (CC). Pérez Molina’s proposal also met with widespread opposition on the grounds that it unfairly targeted middle-class taxpayers.

The Pérez Molina administration argued that the impact on tax revenue as a result of the proposed fiscal reform would have amounted to an additional US$556 million. However, it never managed to meet the target, and Pérez Molina was forced to resign in September 2015 in the wake of a massive customs fraud scandal known as “La Linea” (NotiCen, July 2, 2015, and Sept. 3, 2015).

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