Achieving More Equality and Stronger Growth in Guatemala

By Mario Garza

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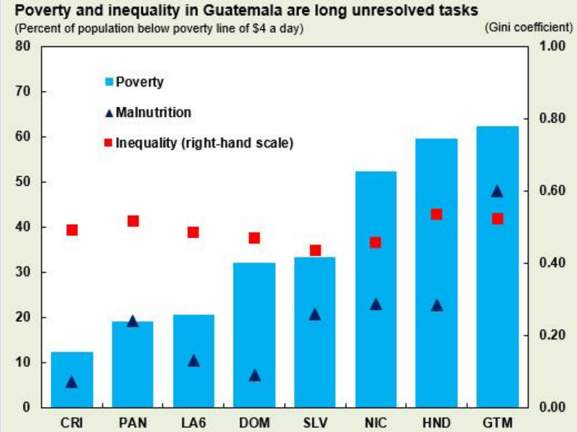
Guatemala's remarkable macroeconomic and financial stability has been a benchmark for Central America. Recently, the country launched an exceptional effort to tackle corruption and strengthen the rule of law. Thanks to strong fundamentals, the economy withstood well the political crisis of 2015, which erupted with the prosecution of multiple high-level corruption cases. The economy's prospects look solid thanks to the strength of the United States' economy and low commodity prices.

For the next 6 years, Guatemala's economy is expected to grow at potential, or nearly 4 percent per year. Inflation will stay low, within the central bank target of 4±1 percent, firmly anchored by prudent monetary policy. The country also has ample foreign reserves to provide protection against external shocks. Public debt will remain at 24 percent of GDP, the lowest level in Central America, reflecting Guatemala's tradition of fiscal discipline.

Chart 1
Poverty and inequality in Guatemala are long unresolved tasks



Sources: Instituto Nacional de Estadistica (Spanish Statistics Office); World Bank, *World Development Indicators*; and IMF staff calculations.
Note: Malnutrition refers to the percent of children under 5 years of age. Lower (higher) Gini number means more (less) income equality. CRI = Costa Rica; PAN = Panama; LA6 = Argentina, Brazil, Chile, Colombia, Mexico, and Peru; DOM = Dominican Republic; SLV = El Salvador; NIC = Nicaragua; HND = Honduras; and GTM = Guatemala.

Yet, many families remain immersed in poverty, mainly in rural areas and among the indigenous population (see Chart 1). Clearly, the economy's potential for growth is not enough to provide them with tangible opportunities for prosperity. Our latest report on Guatemala calls for a decisive shift in policies to satisfy pressing social needs and remove obstacles to growth, while further underpinning the stability of the economy (see box).

Guatemala: Five Policy Priorities for Growth and Social Progress

- Raise fiscal revenue and spending to at least 15 percent of GDP
- Place priority on spending on infrastructure, education, health, social support, security, and justice
- Improve tax administration and fiscal transparency to international best practice
- Upgrade the frameworks of fiscal, monetary, and financial sector policy to better manage shocks
- Strengthen institutions to deepen financial inclusion, trade integration, rural development, and women's participation in the labor force.

Reorienting fiscal policy

Guatemala needs to reorient fiscal policy towards social progress and growth. No doubt, this process has to start by resolving the serious governance and collection issues in tax administration that are behind the traditionally low level of tax collections. Still, achieving the desired revenues may take time, so running a fiscal deficit in excess of 2 percent of GDP, if well focused on the poor and in infrastructure projects, would certainly be very feasible for a few years, since such a temporary relaxation does not put debt sustainability at risk.

Equally important, the government needs to articulate a social and growth strategy to lay out the future orientation for fiscal policy. As our report stresses, such a strategy will require the strong support of the Guatemalan society to ignite broad tax and spending reforms. Beyond upgrading tax administration to international best practice, the heart of that strategy is to raise tax revenues to at least 15 percent of GDP over time; since the current level of 10 percent is one of the lowest in the world and has impaired the redistributive role of fiscal policy, leaving the problem of inequality unattended for many years.

This strategy will help boost Guatemala's public spending in projects to eradicate extreme poverty and raise social standards, especially on nutrition, childcare, and education, as outlined in the Sustainable Development Goals. It will also reallocate resources for growth-oriented infrastructure projects and ongoing efforts against corruption and crime, and to strengthen the judicial system.

To secure the buy-in of the Guatemalan society, the government needs to deliver visible progress on transparency, accountability, and efficiency of public spending. This essential ingredient will help garner support for the difficult tax reforms that Guatemala needs. This strategy should also include measures to ease the high earmarking of revenue, which will provide more flexibility to reorient the budget.

Boosting growth

Guatemala needs more physical and human capital and higher productivity to achieve stronger inclusive growth (see Charts 2 and 3). The authorities rightly plan to broaden economic opportunities with policies to expand financial inclusion, improve the business climate (through less corruption and crime), and intensify sectoral competition. These efforts will supplement very well our proposed increases in public spending on education and infrastructure. Actions to foster women's participation in the labor force, promote rural development, and deepen regional and global trade integration are also essential.

Our report also highlights that the economy's stability could be reinforced to support conditions for stronger inclusive growth. This will include measures to strengthen the monetary policy framework (such as making the exchange rate more flexible and covering central bank losses) and the financial system (with plans for stronger capital buffers, lower credit dollarization, closer monitoring of foreign borrowing, and stricter anti-money laundering supervision).

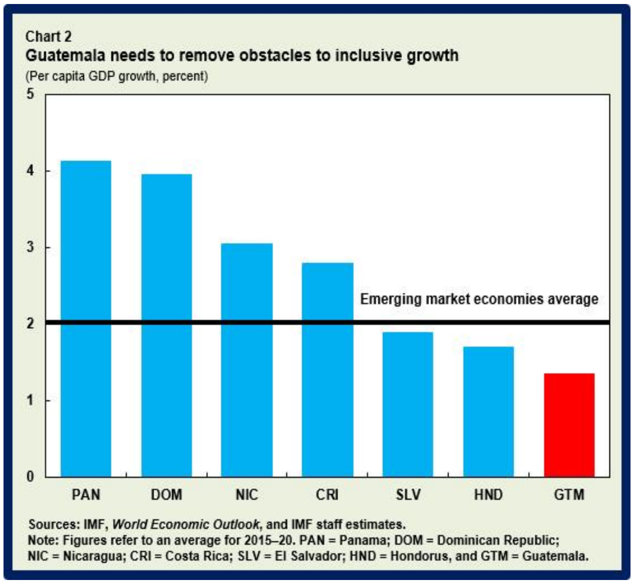


Chart 2
Guatemala needs to remove obstacles to inclusive growth

Sources: IMF, *World Economic Outlook*, and IMF staff estimates.
Note: Figures refer to an average for 2015–20. PAN = Panama; DOM = Dominican Republic; NIC = Nicaragua; CRI = Costa Rica; SLV = El Salvador; HND = Hondorus, and GTM = Guatemala.

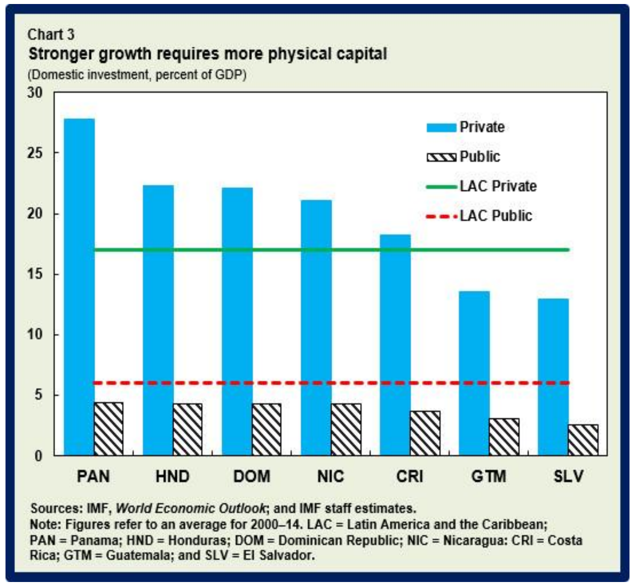


Chart 3
Stronger growth requires more physical capital

Sources: IMF, *World Economic Outlook*; and IMF staff estimates.
Note: Figures refer to an average for 2000–14. LAC = Latin America and the Caribbean; PAN = Panama; HND = Honduras; DOM = Dominican Republic; NIC = Nicaragua: CRI = Costa Rica; GTM = Guatemala; and SLV = El Salvador.

Guatemala faces a key turning point. So far, the country has been unable to translate its remarkable economic stability into social gains for the many. But the country is now demonstrating a strong conviction to work together in the difficult fight against corruption. With the same conviction, political leaders, civil society, and other stakeholders should unify efforts around socially-responsible policies to lift out of poverty over 9 million Guatemalans that now lack fair economic opportunities.

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