

The Fiscal Covenant in Guatemala: lessons learned from the negotiations

Juan Alberto Fuentes K. and Maynor Cabrera

Guatemala's recent experience in negotiating a fiscal covenant, together with other efforts –some more successful than others– to achieve social covenants on fiscal policy, may serve as a lesson or suggest key elements for a fiscal covenant. This article analyses the Guatemalan experience in the light of the main determining factors of a number of successful or failed fiscal covenants in countries as diverse as Chile, Indonesia, Poland, the Russian Federation, Sweden, the United Kingdom and the United States. In conclusion, the authors identify 10 key components of a successful fiscal covenant, based on Guatemala's experience and that of the other countries mentioned above.

Juan Alberto Fuentes K.
Director,
Central American Institute
for Fiscal Studies (ICEF)
✦ fuentesknight@yahoo.com

Maynor Cabrera
Consultant to the United Nations
Development Programme
and the Ministry of Planning
of Guatemala
✦ mynorvc@yahoo.com

I

The institutional framework of Guatemalan fiscal policy prior to the adoption of the Fiscal Covenant of 2000

Successive governments throughout Guatemala's history have been obliged to undertake tax reforms to deal with the inherent weakness of the country's public finances. It would seem that each administration has "discovered" this weakness and attempted to resolve it without fully understanding its nature or the major challenges that it raises. These initiatives have come up against very strong and well-organized interest groups, united in a confederation of business chambers, the Coordinating Committee of Agricultural, Commercial, Industrial and Financial Associations of Guatemala (CACIF), which has generally had direct access to the Executive and has been able to wield considerable influence over tax policy.¹ The direct and institutionally unmediated relationship between the economic powers and the Executive has taken two forms: (i) negotiation by elites, which has been reflected in a few minor tax reforms agreed between a technocratic elite and a business elite; or (ii) confrontation, a situation in which the private sector has resorted to lockouts, mobilization of public opinion through the media or the filing of complaints of unconstitutionality to invalidate by legal means possible increases in taxes.

Some articles of the 1985 Constitution weakened the position of the fiscal authorities and strengthened that of taxpayers. For example, a taxpayer wishing to contest tax resolutions cannot be required to pay the tax in advance, and the fines and interest on arrears must not exceed the value of the unpaid or overdue tax, since the Constitution deems this to be confiscatory. According to ECLAC, these clauses reflect the fact that in Guatemala, property rights are mixed with tax obligations, which does not occur in other countries such as El Salvador or Costa Rica.² Furthermore, the Constitution prohibits double taxation in very vague

terms, which has given rise to multiple interpretations of this clause so that it is difficult to determine whether tax reforms adopted by Congress are applicable or not.

The Constitution also allows any citizen or company, with the assistance of three lawyers, to file a complaint before the Constitutional Court—the highest court on matters relating to the Constitution of Guatemala— which may, if it considers that a law infringes any constitutional right, declare it invalid. According to ECLAC, this means that the negotiation of taxes is tantamount to a "direct negotiation between the State and the propertied classes", whereas in other countries, such as Costa Rica or El Salvador, it is in the Congress and in the political arena that the tax authority of the State is defined (ECLAC, 1996).

Consequently, tax negotiations are not concentrated principally on the approval of legislation by Congress, since such approval can be changed relatively easily by the Constitutional Court if a complaint of unconstitutionality is filed. In this new context, governments may be faced with a reduction of their financial resources when least expected, as occurred in 1994, when the tax burden was reduced by 1% of GDP because a tax law was declared unconstitutional.

Table 1 lists the various initiatives launched between the 1980s and the year 2000 (when the Fiscal Covenant for a Future of Peace and Development was signed), together with the private sector's response and the final outcome of the initiative. Three conclusions are evident. First, situations of confrontation predominated, with CACIF asserting its "veto power" through lockouts, denunciation campaigns in the media, and the filing of complaints of unconstitutionality (which occurred irrespective of the type of government: regardless of whether it was military or civil and whether it had a majority in Congress or not).

When negotiations did take place, they took the form of "elite negotiations" between a technocratic elite and business leaders; the real forum for negotiations was not the democratic institutions of the

¹ See McCleary (1999, p.108), Valdez (2000, p.12), Martí and Ortiz (1993), Valdez and Palencia (1998), Urrutia (2000) and Palencia (2002).

² For a comparative analysis, see ECLAC (1996).

TABLE 1

Guatemala: Summary of tax reforms and their results, 1980-1999

Government and year of reform	Government proposals	Form of action used by CACIF	Outcome	Change in tax burden
<i>Cases of confrontation</i>				
<i>Military regime with internal armed conflict</i>				
Ríos Montt (1983)	10% value added tax (VAT) Elimination of export duties Regulations on customs valuation Luxury tax	Support of the Chamber of Commerce for VAT in exchange for non-approval of the regulations on customs valuation and the luxury tax. Anti-tax campaigns in the media	Adoption of VAT and elimination of import duties	-1.9% (between 1982 and 1984)
Mejía Victores (1985)	Reduction of VAT to 7% Tax on coffee Expansion of the VAT base Amendment of the tax on petroleum derivatives	Opposition to measures Anti-government campaigns in the media Repeal of laws	Dismissal of the ministers of the economy and public finance	1.7% (between 1984 and 1986)
<i>Democratic regimes with internal armed conflict</i>				
Vinicio Cerezo (1987)	Temporary tax on exports Changes in income tax Changes in VAT Property tax	Opposition to measures through lockouts and filing of complaints of unconstitutionality	Temporary tax on exports not approved. Reforms to income tax, VAT and property tax declared unconstitutional	1.7% (between 1986 and 1988)
Ramiro de León (1994)	Changes in income tax Equalization of rates of specific taxes (on beverages, petroleum derivatives and tobacco) with those applied by other Central American countries. Increase of VAT to 10%	Opposition to measures through filing of complaints of unconstitutionality and anti-government campaigns in the media	Increase in VAT (1996)	1.6% (between 1993 and 1996)
<i>Cases of negotiation by elites</i>				
<i>Democratic regimes with armed conflicts</i>				
Jorge Serrano (1992)	Reduction of marginal income tax brackets and ceilings Simplification of VAT Possibility of crediting VAT against income tax	Negotiations without other actions	Adoption of reforms	0.5% (between 1991 and 1993)
<i>Democratic regimes with Peace Accords</i>				
Alvaro Arzú (1996-1998)	Reduction of income tax rate Simplification of VAT Elimination of exemptions Temporary taxes on sales and assets (1996 and 1998)	Negotiations without other actions	Adoption of reforms	0.4% (between 1996 and 1998)

Source: Prepared by the authors on the basis of Valdez and Palencia (1998), Urrutia (2000) and McCleary (1999) and data from the Ministry of Public Finance.

Box 1

FISCAL REFORM: ACTORS AND STYLES OF NEGOTIATION AS FACTORS OF SUCCESS

In Sweden, the United Kingdom and the United States, the legislative power and the main political parties arrived at agreements within a clear and stable framework of rules. Thanks to this framework, shifts in the correlation of forces could give rise to new policies without altering the basic rules of the game, while at the same time the institutional framework moderated the initiatives and strength of employers' associations and labour unions, particularly in Sweden and the United Kingdom. Moreover, the Executive, with its solid capacity for tax collection and the degree of autonomy enjoyed by its technocrats, ensured that reforms could be properly implemented.

In Chile, there was a process of consultation with labour sectors and the position of Chilean business leaders was taken into account in the formulation of reform proposals, but these were negotiated directly between the ruling Democratic Coalition and Renovación Nacional, the main opposition party (Boylan, 1996). At the same time, the Ministry of Finance's capacity for revenue collection and its technical and political independence did not leave any doubt as to its ability to implement proposed reforms.

In Poland, the government encouraged negotiations between workers and the State and these culminated in the signing of a social covenant covering both the question of wages –agreed through a tripartite committee of managers, government and workers– and tax policy, which was then ratified by the legislative body.

The Russian Government settled for negotiations with elites, which were a far cry from the collective bargaining that took place in Poland. In particular, the government arranged informal negotiations with (i) regional governors, giving rise to bilateral agreements on the division of revenues between the central government and local governments; (ii) managers of State-owned enterprises producing raw materials for export, which were the main sources of revenue, and (iii) entrepreneurs of the financial sector, who became the principal sources of credit for the government as well as administrators of State resources. These negotiations did not lead to lasting agreements.

Another experience with fiscal reform, which was hailed as a success at the time, was that of Indonesia, although in this case there was no democratic institutional framework to mediate between the pressures of different groups, owing to the dictatorial nature of the regime of President Suharto, who was Indonesia's Head of State for 30 years. This allowed a small group of national experts, with international advice, to establish a vast set of measures which included the introduction of a value added tax, the simplification and strengthening of income tax, and the streamlining of other laws to facilitate the tax administration but which lacked broad-based political and social support.

country, and much less the National Congress. Lastly, when such elite negotiations took place, the proposals which succeeded in gaining acceptance were those aimed at simplifying the tax system or increasing VAT and eroding direct taxation (even through the application of temporary taxes) at a time when there has been pressure to increase it. As may be seen from box 1, the involvement of the main actors and the styles of negotiation adopted have been important in international experiences.

Thus, the main features of fiscal policy in Guatemala prior to the signing of the Fiscal Covenant

in 2000 were as follows: low tax income and limited allocations for social spending, deficiencies in the management of this expenditure (lack of technical instruments for measuring the quality of expenditure), and a high concentration of expenditure in the central region of the country.³ This helps to explain why Guatemala is lagging furthest behind the rest of Latin America in terms of social indicators.

³ For a more detailed description, see SNU (2001, pp. 3-36 and 125-178).

II

Negotiation of the Fiscal Covenant in Guatemala

1. Factors behind the emergence of the Fiscal Covenant

After more than 30 years of internal armed conflict and a long-drawn-out negotiation process, Peace Accords were signed in Guatemala in 1996. The end of the war, together with the commitments contained in those Accords, raised the expectations of citizens and of the government itself, by establishing a political covenant providing for the minimum basic understandings required for the construction of a new country. The Agreement on Social and Economic Aspects and the Agrarian Situation (ASESA), which was one of the most important of the set of Peace Accords, stated that by the year 2000 the tax burden should be at least 50% higher than in 1995 in order to provide financing for the programmes and projects designed to consolidate the peace process.

The agreements signed provided for a 50% increase in public spending on education and health (as a proportion of GDP) between 1996 and 2000, as well as other targets for increased expenditure on housing and justice, together with a moderate reduction in military spending. The Peace Accords also stated that the United Nations would be responsible for monitoring the fulfilment of these goals.

By the end of the 1990s, tax collection figures showed that the target of a tax burden of 12% of GDP in 2000 (compared with approximately 8% of GDP in the mid-1990s) was not going to be met.⁴ Recognizing this fact, the Guatemalan Government advocated modification of the timetable for reaching the targets established in the Peace Accords, postponing until 2002 the date for achieving the tax target. As part of the negotiations to secure agreement on this modification, the government pledged to push forward various tax laws, which included the establishment of an income-tax-deductible tax on sales and assets, known as the tax on commercial and agricultural establishments

(IEMA); the reduction of the extent to which payments of VAT could be credited against income tax; redrafting of the property tax; and measures to improve tax collection, such as the hiring of auditing companies to check foreign trade transactions.

What subsequently proved to be most important, however, was the government's additional commitment to take steps towards the signing of a fiscal covenant to promote concerted tax reform, create a new tax culture and strengthen the capacity for managing fiscal policy.⁵ The idea of a fiscal covenant –inspired partly by the ECLAC book of the same name (ECLAC, 1998)– was above all a response to a long history of failed tax reforms promoted in confrontational situations in which, as already explained, complaints of unconstitutionality, lockouts and massive media campaigns were used to stave off the implementation of proposed tax reforms.

The idea of promoting a fiscal covenant was based on the assumption that tax reform would only be sustainable if it was supported by consensus (in other words, if tax compliance were practically voluntary), in order to protect it against the forcible measures taken by various trade union or political entities. This called for a new institutional framework which would prevent individual social forces from exercising a power of veto and would thus be consistent with the existence of true democracy.⁶

2. The negotiation of the Fiscal Covenant: an attempt to create a new institutional framework

(a) *The Fiscal Covenant as a global agreement*

Negotiation of the Fiscal Covenant was started at the initiative of the members of the Committee to Monitor the Fulfilment of the Peace Accords. This Peace Committee was composed of representatives of the government, of the political party representing the

⁴ The revision scheduled of the national accounts in Guatemala may alter these proportions of the tax burden (8%, 10% or 12%), but this does not detract from the original ASESA agreement, which established the need to increase the tax burden by 50% over the 1996 level.

⁵ For a description of the relationship between the Fiscal Covenant and the Peace Accords, see Noriega, Alvarez and Chocoj (2001).

⁶ Rosenthal (2005) highlights the importance of this condition in the Guatemalan context.

former insurgent forces, Guatemalan National Revolutionary Unity (URNG), eminent citizens identified as representatives of civil society, and United Nations representatives with observer status.

As a first step, the Committee appointed a commission, entitled the Preparatory Commission for the Fiscal Covenant (CPPF), to prepare –in consultation with representatives of different sectors of Guatemalan society– a proposal for the adoption of the fiscal covenant based on technical studies. This Preparatory Commission gave technical and political credibility to the process, since its members, as well as having a broad-based store of knowledge on fiscal issues, constituted a pluralistic group representing the different perspectives on the fiscal question in Guatemala, and some were closely related with the main political parties of the time.⁷

Despite the fact that the preparatory process of the Fiscal Covenant took place during an election year, an intensive series of consultations was held with different sectors (the academic world, the private sector, trade unions, the cooperative sector and political parties) from all over the country, and the media gave broad and positive coverage to the issue; solid technical support was also provided by international cooperation agencies,⁸ which was extended to various academic and social organizations, thereby publicising the issue and contributing to extensive debates on it during the year. This culminated in the proposal for a Fiscal Covenant, which was presented publicly by the Preparatory Commission on 29 December 1999. This proposal had two features: (i) it took an integral approach, since it referred not only to tax reform but also to the whole area of public finances: public expenditure, tax administration, debt, deficit, public assets, transparency and decentralization; and (ii) it was oriented towards principles and commitments, with a medium- and long-term view, instead of being centred exclusively on short-term measures.

In February 2000, the Peace Committee sent out an invitation to take part in consultations on the proposal prepared by the Preparatory Commission to

nearly 150 organizations and institutions of different types: trade unions and representatives, small and medium-sized enterprises, business chambers, cooperatives, churches, non-governmental organizations, peasant, indigenous and women's organizations, universities and research centres. In response, 48 proposals were received, representing 131 organizations. On the basis of these proposals, a technical team appointed by the Committee to Monitor the Fulfilment of the Peace Accords identified the main points of consensus and dissent. The Committee then carried out a campaign to reconcile positions between the organized business sector and social organizations. After a period of dialogue and negotiation, two different positions took shape with regard to the various issues.

After this campaign and the holding of the National Forum on the Fiscal Covenant, which brought together the organizations that had sent in proposals, final agreement was reached and the Fiscal Covenant was signed by more than 100 organizations, as well as by the representatives of the three State powers. On the whole, while there were lengthy negotiations on some sensitive issues, such as the progressiveness of the tax measures, the use to be made of the proceeds of privatization operations, and the constitutional reforms, most of the proposals made originally by the Preparatory Commission were respected and the same structure based on the establishment of principles and commitments for the whole set of public finance issues was maintained.

Gamboa and Tentravizi (2001, pp. 131-139) point out that the agreement finally reached on the Fiscal Covenant, which in the past had aroused a great deal of controversy, was largely due to factors such as the characteristics of the Preparatory Commission (its representativeness and high technical level), the identification of principles and commitments geared to the medium and long term instead of discussions on tax measures, and the existence of a single document as the basis for the debate. Other positive factors included the favourable framework provided by the Peace Accords, the unity displayed by the social organizations, which constituted to some degree a counterweight to CACIF, a flexible negotiation method, which took advantage of the experience gained in negotiating the Peace Accords, and a collective learning process which gave some flexibility or fluidity to the positions of the participants, facilitating convergence among them. In practice, this represented the entry of new actors into the discussion of an issue which had traditionally been the subject of

⁷ According to Gamboa and Tentravizi (2000, pp. 53-72), the membership of CPPF was fairly well-balanced, as it consisted of representatives of left-wing and moderate right-wing positions, the main economic advisors of the government party, and members of the leading opposition party.

⁸ For the studies which served as the basis for the proposal of the Fiscal Covenant, see Preparatory Commission for the Fiscal Covenant (2000).

negotiations within a small group of senior government officials and private-sector representatives.

During this preparatory and negotiation stage, the two governments in power (the first from 1996-1999 and the second from 2000-2003) strongly supported the formulation and discussion of the Fiscal Covenant, albeit without playing a leading role. For its part, the business sector was in agreement with this process, partly because of its fear of the Guatemalan Republican Front (GRF). This political party had won the elections in 1999 with a populist, anti-business discourse, and entrepreneurs therefore viewed the Fiscal Covenant as potentially useful for defining a framework of rules that would provide a certain degree of stability and

transparency to govern the role of the new administration and its relations with other sectors (Segovia, 2004, p.64).

This may be interpreted as the change in the correlation of forces which has favoured the negotiation of fiscal covenants in other circumstances, as shown in box 2. It should be recognized, however, that the perspective of a change of government every four years and the need for a certain stability and a shared vision of nationhood⁹ may also have been an incentive to take a positive view of the efforts to agree on a fiscal covenant: a position which was already evident months before the elections in which the Guatemalan Republican Front was victorious.¹⁰

Box 2

CHANGE IN THE CORRELATION OF FORCES AS A PREREQUISITE FOR A NEW FISCAL COVENANT

In the developed countries, the quasi-voluntary tax system has been subject to renegotiations, giving rise to adjustments in the social covenants underlying fiscal policy which have been reflected in new or renewed fiscal covenants. Thus, without going into details about the basic institutional framework and the advantages of having a quasi-voluntary tax system, the history of those countries provides examples of what may be interpreted as new or renewed fiscal covenants, as occurred in Sweden in 1938, the United Kingdom between 1939 and 1941 and the United States in 1986 (Steinmo, 1993).

Each of these was triggered by some special event which altered the internal or external correlation of forces: (i) the victory of the social democrat party in the Swedish elections in 1936, which gave rise to a pact negotiated between management and labour – the basis for what was dubbed the “Swedish model”, which subsequently became firmly entrenched; (ii) in the case of the United Kingdom, the Second World War, which called for a special effort to mobilize resources to finance the armaments industry; and (iii) the electoral victory of Ronald Reagan, combined with the substantiated reports that the tax burden of the major corporations in the United States had gone down between 1981 and 1986.

The case of Chile, a developing country which has had a successful fiscal covenant since 1990, clearly illustrates how fiscal policy is associated with the strengthening of democracy and how a new correlation of forces contributes to such strengthening and to fiscal reform, giving rise to positive feedback between the two processes. The event which triggered this initiative was the establishment of a new correlation of internal forces, demonstrated initially by the rejection of the military dictatorship in the 1988 plebiscite and ratified in the 1989 elections with the victory of the centre-left forces (Christian Democrats, socialists and others) grouped together in the Coalition for Democracy. This, together with a growing fiscal deficit and with promises to reduce the social debt, led to the negotiation of a reform within its fledgling institutions, with a legislative power subject to restrictions imposed by the military government,¹¹ but with institutionally sound political parties, which were the pivot of the tax reform negotiation negotiations.

In Poland, which also adopted a new fiscal covenant, a transition was initiated in 1989 with a government supported by the Solidarity Movement, but with a legislature which, owing to the result of the 1991 elections, was fragmented and virtually paralysed.¹² With the institutional framework in a state of flux, the correlation of forces shifted in favour of industrial, rural and public-sector workers, who resorted initially to protest action –including strikes– in the face of the radical economic reforms introduced by the new government and in opposition to a tax on wages above a certain level (the *popiwek*).

⁹ Palencia (2002, pp. 79-97 and p. 63). See also Valdez (2003).

¹⁰ Although to the extent that there were “rational” expectations of the FRG victory, these were already being internalized or processed as part of the near future.

¹¹ At that time, the Senate included nine senators designated by the military regime, so that the votes of the Renovación Nacional party were decisive for achieving a simple majority in this body.

¹² The following account is based on Easter (2002).

The broad-based agreement on the Fiscal Covenant included the URNG political party and a number of social and labour organizations, which put forward proposals on the issue, taking advantage of the discreet and low-key support provided by international cooperation agencies. As a whole, the international community supported the negotiation process, highlighting the importance of meeting the 12% tax target set out in the Peace Accords, although the international finance institutions nevertheless expressed reservations on the grounds that the government might use the process as an excuse to renege on its agreement to increase the tax burden. Consequently, these institutions gave some technical support but kept their distance, which had a positive effect in the sense that it ensured genuine national “ownership” of the project. Other sources of cooperation helped actors from civil society –social and academic organizations– to carry out studies and make proposals, thus reducing the historical asymmetry characteristic of fiscal policy management, which in the past, had been restricted to government and corporate actors.

Although the Preparatory Commission had consulted the political parties during the preparation of its proposal, and although the electoral platforms of the parties included generic support for the idea of establishing a fiscal covenant, not all the parties supported it after its final negotiation –least of all the Partido de Avanzada Nacional (PAN) of the former government, which subsequently went over to the opposition. The political parties have always been apprehensive about the political cost associated with the taxes, and they were reluctant to accept or understand the argument that the covenant allowed this cost to be shared by all.

This attitude was influenced by the recognized precariousness of the political party system in Guatemala, characterized by fragmentation, a tendency towards caudillism, inconsistency and limited durability. Furthermore, there was a fundamental strategic flaw in the negotiation phase of the fiscal covenant, insofar as the effective participation of the newly elected Congress was not assured, although individual deputies did participate, including the Chairman of the Finance Committee of Congress.¹³ This heralded what was perhaps the main weakness of

¹³ Congress was represented on the Monitoring Committee, but this was not sufficient to ensure solid coordination with the legislative power as a whole.

the new institutional framework for putting the fiscal covenant into practice.

(b) *Failure of the negotiations on the tax component of the Fiscal Covenant*

Since the principles and commitments contained in the global agreement on the fiscal covenant were of a more general nature, it was easier to reconcile the different trade union and sectoral visions and to discuss concrete measures, above all, the approval or modification of taxes. The participants in the subsequent negotiations on the tax reform, under the auspices of the Monitoring Committee, were the social organizations that made up the Collective of Social Organizations (COS), the organized business sector, represented by the Coordinating Committee of Agricultural, Commercial, Industrial and Financial Associations of Guatemala (CACIF), and the main research centres: the National Economic Research Centre (CIEN) and the Association for Social Research and Studies (ASIES). The Monitoring Committee acted as moderator and the United Nations Mission for the Verification of Human Rights and of Compliance with the Commitments of the Comprehensive Agreement on Human Rights in Guatemala (MINUGUA) provided active technical and facilitation support.

There were, however, two problems that undermined this negotiation process. First, the Ministry of Finance played only a secondary role in the negotiations, partly because of apparent disagreements within the government, due to the reluctance of the latter to take part in the process because of the Coordinating Committee’s disproportionate role and because it denied the government the legitimacy it had won through the elections. In practice, the extreme weakness of the Executive, reflected in its incapacity to coordinate positions on the issue, prevented the consolidation of the new institutional framework that was taking shape and was one of the causes of the failure of this initiative. The negotiations were more complex on this occasion, with disagreements on the relative importance that direct or indirect taxes should have and on the exemptions that ought to be eliminated,¹⁴ giving rise to extreme

¹⁴ For the social sectors, the crucial issue was the increase in VAT, which caused internal divisions even afterwards. The VAT negotiations were contingent on an increase in the minimum wage, while for the private sector, the negotiation of fiscal privileges and direct taxation was the issue that aroused the strongest confrontations with the social sectors (see Palencia, 2002).

positions and setbacks that delayed the timely presentation of the agreement to Congress. Even so, it was possible to secure consensus on the Political Agreement for Financing Peace, Development and Democracy, which contained concrete measures for achieving the tax burden target of 12%.¹⁵

Second, the inability of the Executive to coordinate positions was compounded by the fact that the majority party in the Congress (FRG) did not welcome the new proposal that had been agreed, on the grounds that the deputies had not participated in the prior negotiation process, highlighting the fact that Congress could only play a limited role as a mediating and negotiating body at the highest political level.¹⁶ Paradoxically, the legislative body, and in particular its president, General Ríos Montt, failed to take advantage of the opportunity to adopt a significant tax reform without major political costs, with increases in the income tax and VAT rates already approved by the private sector and the leading social organizations in the country. Thus, they passed up an opportunity to reach a genuine fiscal covenant.

(c) *The return to the former institutional framework*

(i) *The return to confrontation.* The government and the party supporting it then decided to convene new negotiations led by the Vice-President of the Republic. These were a failure and even led to a withdrawal to some previous positions, mainly on the part of the social organizations, which then rejected the increase in VAT. In that year, 2000, the Congress, with the support of most of the deputies of the government party, approved some of the reforms included in the Political Agreement, but without including the increase in VAT. This was done in a climate

of growing confrontation with the private sector and without the support of the social organizations and the opposition parties in Congress.

Following the approval of the tax laws and in view of the inadequacy of the measures applied, there was still the threat that the VAT might be approved, subject to divergences between Congress and the executive power. When the private sector, the media and the social organizations started to challenge the government,¹⁷ the government strategy was revised. The Minister of Public Finance was replaced and the government adopted two measures: it raised the VAT rate from 10% to 12%, as proposed in the previously negotiated Political Agreement, and increased the rates of the tax on assets and sales of commercial and agricultural establishments (IEMA). The prevailing climate was one of increasing polarization, and this led the social organizations and the private sector as well as the non-government parties to reject these measures out of hand.

While the signing of the fiscal covenant was a high point in the history of concerted action in Guatemala, the rise in the VAT and IEMA rates in 2001 was one of the lowest points because of the degree of confrontation that existed. This confrontation took on different forms: mass demonstrations by the social organizations, media campaigns against the Government, a lockout in the private sector¹⁸ and citizen protest campaigns, in which citizens wore black, primarily as a rejection of the increase in VAT and alleged government corruption. There was also a sharp increase in the number of complaints of unconstitutionality filed, which had not been the case in 2000, when the Fiscal Covenant was signed, thus showing the credibility of the negotiation of the covenant. In 2001, in contrast, 41 complaints of unconstitutionality were filed (31 by the business sector, three by political parties and the remainder by civil society); in 2002 nine were filed (five by the business sector and four by civil society), and in 2003, 11 were filed (six by the business sector and five by civil society).

(ii) *The return to a (broader) form of elite negotiation.* Following the victory of the Grand

¹⁵ In short, the agreement reached –known as the Political Agreement– included: (i) strengthening of tax administration and measures for combating tax evasion and smuggling; (ii) the review of existing deductions and exemptions; (iii) an increase in VAT from 10% to 12%; (iv) a rise in the maximum income tax rate from 25% to 31%; (v) other tax measures, including an increase in the tax on persons leaving the country, a new tax on alcoholic beverages, a new property tax law and the conversion of the temporary tax on assets into a permanent tax; (vi) an increase in minimum wages; (vii) the implementation of an economic reactivation programme; and (viii) the implementation of a priority public spending programme.

¹⁶ At the same time that the Monitoring Committee was presenting the Political Agreement to Congress, the Ministry of Finance was presenting another proposal which excluded VAT and included a tax on financial transactions, thus adding to the complexity of the negotiation of the proposed reforms.

¹⁷ Mainly because various cases of corruption and weak public management had come to light.

¹⁸ In this case, the expressions of private-sector dissatisfaction with the increase in VAT were due to the sector's rejection of the management of the government in power, rather than of the tax itself.

National Alliance (GANA) in the 2003 general elections, the new government assumed a pro-business orientation. Paradoxically, the persistent complaints of unconstitutionality filed by the private sector in previous years—especially the resulting declaration of unconstitutionality of the tax on assets and sales (IEMA)—generated a loss of tax revenue for the new government which took office in 2004. During its first months in office, the new government therefore decided that it was necessary to modify the fiscal covenant in order to cope with the crisis. To this end, the Executive formed a Technical Committee on the Fiscal Covenant (CTPF),¹⁹ which was entrusted with the task of preparing a draft tax reform.

This time, the consultation process was fairly limited. On the one hand, the close relationship between the Technical Committee and senior government officials not linked to fiscal policy meant, in view of the government's pro-business stance, that the business sector's main concerns were taken into account. On the other, the Committee's technical mandate helped to establish a belated but rapid process of consultations with other sectors, without prior consultation with the parties represented in Congress. At all events, the Technical Committee's proposal was finally presented to the National Committee on the Peace Accords (CNAP),²⁰ and submitted by the latter with minor amendments to the Congress of the Republic.

Various sectors argued that the consultations for preparing the proposal were not sufficient to serve as a basis for a fiscal covenant. The Congress of the Republic, however, carried out an additional consultation process, which took the form of public hearings. This mechanism of democratic participation, which had not been used in Guatemala, enabled the Congress to listen to the views of different social, academic, business and indigenous groups—something which had not been done in the country in the last 50 years—and for a brief spell this series of hearings and the fiscal debate it engendered were a breath of fresh air for democracy in Guatemala which enabled the country to go beyond confrontation or elite negotiation.

In actual fact, however, Congress, which once again had not been taken into account in the formulation of the tax reform proposals and did not have the benefit

of specialized advice on tax issues, weakened even further the proposals made by the Technical Committee. This was partly due to complaints by social organizations (which had not been included in a broad-based consultation process), whose positions reflected urban middle-class interests which coincided with the private sector's concern that income tax should not be any higher.

The reforms to the tax laws were only approved once there was understanding between the different groups in Congress. The approved initiatives were four in number: (i) changes in income tax, whereby a streamlined payment regime providing for a tax of 5% on gross income was introduced in place of the 31% rate; (ii) the creation of a special temporary tax in support of the Peace Accords (IETAAP): a tax on assets and sales, similar to the IEMA, but with lower rates and established on a temporary basis, in keeping with the position of CACIF; (iii) a tax on alcoholic beverages, which was not in force because it had been declared unconstitutional; and (iv) authorization to increase the central government debt.

Two features of this reform should be highlighted. First, it introduced only minor amendments that reflected the existence of an elite negotiation between the government and CACIF, with the legislative power playing a weak mediatory role and agreeing to measures of simplification or of a low impact, with a temporary component in terms of direct taxation, all of which was consistent with the Guatemalan private sector's traditional approach to taxation. Second, the incomplete approval of the reforms only generated half the funds that the original reform would have obtained. In fact, the reform that was finally adopted was insufficient even to make up for the income lost because of the complaints of unconstitutionality, so that the tax burden was maintained at 10.3% in 2004: equivalent to the 2003 level, but lower than in 2002 (10.6%). When fiscal policy is analysed in full, however, there are some other advances which should be recognized, including the (recent) strengthening of tax administration²¹ and a greater degree of transparency

¹⁹ Which replaced the Monitoring Committee on the Fiscal Covenant.

²⁰ This body replaced the Monitoring Committee on Fulfilment of the Peace Accords (CAAP).

²¹ Moreover, despite the fact that the Office of the Superintendent of Tax Administration (SAT) was conceived as an autonomous and technical entity, the continuous turnover of authorities (five superintendents in eight years of existence) has made it difficult to develop long-term policies. In addition, the transparency of the entity was strongly affected in the year 2003, when the former Comptroller of Accounts (who was later prosecuted for unlawful enrichment) was appointed director of this entity.

TABLE 2

Guatemala: Tax reforms and their outcome following the Agreement on the Fiscal Covenant, 2000-2004

Government and year of reform	Government proposals	Instruments for action	Outcome	Variation in tax burden
Cases of confrontation				
Alfonso Portillo (2000)	Increase of VAT ^a to 12% Increase in IT ^b Reduction in the extent to which VAT payments can be set off against income tax Elimination of exemptions and deductions Modification of specific taxes (on tobacco, cement, beverages)	Negotiation, except with respect to the taxes on alcoholic beverages, which were challenged through complaints of unconstitutionality	Adoption of reforms on exemptions and deductions and specific taxes Increase in income tax	0.4% (between 1999 and 2001)
Alfonso Portillo (2001)	Increase of VAT to 12% Increase of rate of IEMA ^c Increase in the rate of specific taxes (alcoholic beverages) Reduction of exemptions and deductions	Lockout Filing of complaints of unconstitutionality Media campaigns against the government. Public protests by social organizations	Adoption of all the reforms Reforms in IEMA, income tax, and other specific taxes declared unconstitutional	1.2% (between 2000 and 2002) Repeal of IEMA and other taxes represented a 1.6% variation
Cases of elite negotiation				
Oscar Berger (2004)	Replacement of the tax on sales and assets Modifications in income tax and specific taxes (beverages) Modifications in VAT	Negotiation Public protests by social organizations regarding VAT and income tax on wages	Adoption of reform, but without modifications in VAT and income tax on wages Reduction of rate and period of application of tax on sales and assets	Estimated temporary impact, 1.0%

Source: Prepared by the authors on the basis of data from the Ministry of Public Finance.

^aVAT: value added tax.

^bIT: income tax.

^cIEMA: tax on commercial and agricultural establishments.

of public expenditure. The most important and intractable problem remains unsolved, however: the insufficiency of tax revenues.

In short, the signing of the Fiscal Covenant in 2000 did not give rise to a new institutional framework permitting tax reforms to establish a solid and sustainable tax base in the country, with quasi-voluntary compliance with tax obligations. Reform processes continued to be pursued but, like those that had predominated in previous decades, they were based on confrontation or conceived as a partly cosmetic elite negotiation with little real impact.

Mention should be made, however, of two important changes which took place in the phase following the Fiscal Covenant and could facilitate future negotiations. First, notwithstanding the policy of broad-based alliances, and in spite of doing whatever had to be done to exercise its power of veto, CACIF was unable to prevent the tax reforms imposed by the

government of the Guatemala Republican Front (FRG) in 2001 and 2002, and the “success” of complaints of unconstitutionality filed by CACIF prompted a new and incomplete tax reform, now put forward by a government favourable to the business sector. In other words, CACIF ceased, at least temporarily, to have the power of veto. In addition, the weaker position in which it found itself, together with the less rigid stance of some of its representatives, led it to adopt a more flexible institutional position.

Second, and partly linked to the above, it is important to recognize the incipient but ever-increasing role played by Congress in determining the country’s fiscal policy, as well as the more marked participation of social organizations in the generation of proposals and in monitoring fiscal policy. This has meant that the strategy of elite negotiation of 2004 had to be expanded, albeit belatedly and only partially, to take other actors into account.

To sum up, there is room for some degree of optimism. Both the more moderate positions adopted by CACIF in the recent past and the increased participation by social organizations and Congress in forging fiscal policy point to the possibility of a new institutional and negotiating framework in the future, with Congress assuming a more central and responsible

role, which could give rise to agreed tax reforms based on quasi-voluntary compliance by Guatemalan citizens with their tax obligations in the future. Whether this materializes will depend largely on the strengthening of the political parties, especially those with the capacity to shape a vision of the State for the medium and long term and the will to implement it.

III

Conclusions:

Ten keys to a successful Fiscal Covenant

The foregoing has various implications for future actions by Guatemala or other countries in terms of fiscal policy. On the one hand, there should be clear differentiation between an isolated tax reform which may well lack any solid social or political basis and a social pact on fiscal policy. Fiscal covenants normally include long-term tax reforms that mark the country and its fiscal policy for a long time to come, based as they are on agreements which have been negotiated within the framework of the democratic institutions of the country and which have broad political and social support.²² On the other hand, once a participatory process has been firmly established for reforming and strengthening the institutional framework in which the fiscal policy aimed at guaranteeing an effective social pact) is defined, the experiences of fiscal covenants in Guatemala and other countries suggest the following recommendations:

(i) Take advantage of the opportunities provided by changes in the correlation of internal forces in order to promote a social pact on fiscal policy.

(ii) Have an organization or well-defined institutional arrangement for driving forward the process and ensure that it is technically and politically credible and represents the main sectors involved in the negotiation of the social pact on fiscal policy.

(iii) From the outset, include the political parties and legislative power in the negotiation process, bearing in mind that the sought-for institutional change seeks to democratize the definition of fiscal policy and that this is contingent on the decisive incorporation of

the parties and the legislative power as fundamental components of a democratic regime.

(iv) Base the process on a holistic and long-term approach which can expand the number of issues subject to concessions –without limiting it exclusively to the question of taxation– in order to facilitate agreements. The negotiation of a fiscal covenant should not be interpreted as a process aimed at achieving a short-term tax reform, but as a starting point for a lasting reform of the State, which, based on a change in the correlation of forces, will guide public policy in the future.

(v) Define a well-defined and clear strategy of consultations that not only ensures that the different interests are taken into account but also confers legitimacy on the process and explains its potential components.

(vi) Establish a positive relationship with the media so that they will support the process.

(vii) Disseminate information and studies on the issue, thereby contributing to a collective learning process which can facilitate convergence among positions and the development of a common “language”, which will be conducive to agreements. Serious and accurate statistics are part of such a “language”.

(viii) Use flexible negotiation techniques, bearing in mind the past experience of the country in question.

(ix) Compensate for the unequal bargaining power of different sectors by giving the weaker groups more access to information and by improving their technical and bargaining capacity.

(x) Allocate sufficient time for capacity-building and negotiation in order to achieve the desired results.

²² Merriam (2004) makes a very clear distinction between these two aspects in an analysis of the Fiscal Covenant in Guatemala.

(Original: Spanish)

Bibliography

- Boylan, D.M. (1996): Taxation and transition: the politics of the 1990 Chilean tax reform, *Latin American Research Review*, vol. 31, No. 1, Pittsburgh, The Latin American Research Association.
- Easter, G. (2002): Politics of revenue extraction in post-communist states: Poland and Russia compared, *Politics and Society*, vol. 30, No. 4, London, Sage Publications.
- ECLAC (Economic Commission for Latin America and the Caribbean) (1996): *Economía política de las reformas tributarias en Costa Rica, El Salvador y Guatemala, 1980-1994*, LC/MEX/L.294, Mexico City, ECLAC Subregional Headquarters in Mexico.
- _____ (1998): *The Fiscal Covenant: Strengths, Weaknesses, Challenges*, LC/G.1997/Rev.1-P, Santiago, Chile. United Nations publication, Sales No. E.98.II.G.5.
- Gamboa, N. and B. Tentravizi (2000): *La Guatemala posible: la senda del pacto fiscal*, Guatemala City, Asociación Centroamericana Hombres de Maíz, United Nations Office for Project Services/United Nations Guatemala Verification Mission.
- Martí, W.J. and R.E. Ortiz (1993): *El sector privado y el Estado guatemalteco (1871-1993)*, Libro No. 46, Guatemala City, Centro de Estudios Urbanos y Regionales, Universidad de San Carlos (USAC).
- McCleary, R. (1999): *Imponiendo la democracia: las elites guatemaltecas y el fin del conflicto armado*, Guatemala City, Librerías Artemis Edinter.
- Merriam, R. (2004): *The Guatemalan Fiscal Pact: Can It Help Strengthen the Fiscal Social Contract?*, Brighton, Institute of Development Studies, University of Sussex.
- Noriega, A., E. Alvarez and M. Chocoj (2001): *Cuando la sociedad guatemalteca se encuentra: la negociación política del pacto fiscal*, Guatemala City, Editorial Serviprensa.
- Palencia, M. (2002): *El Estado para el capital*, Guatemala City, Latin American Faculty of Social Sciences (FLACSO).
- Preparatory Commission for the Fiscal Covenant (2000): *La política fiscal en Guatemala*, Guatemala City, Artgrafic.
- Rosenthal, G. (2005): Lecture by Gert Rosenthal in the Netherlands Institute for Multiparty Democracy, *Empresariado, política y Estado*, Conference Cycle, Guatemala City, Magna Terra Editores.
- Segovia, A. (2004): *Modernización empresarial en Guatemala. ¿Cambio real o nuevo discurso?*, Guatemala City, F y G Editores.
- Steinmo, S. (1993): *Taxation and Democracy*, New Haven, United States, Yale University Press.
- UNS (United Nations System) (2001): *Guatemala: el financiamiento del desarrollo humano*, Guatemala City.
- Urrutia, E. (2000): Ensayo sobre la viabilidad política del pacto fiscal, *Colección de educación fiscal*, No. 10, Guatemala City, Latin American Faculty of Social Sciences (FLACSO).
- Valdez, F. (2000): La viabilidad de un pacto fiscal en Guatemala: para los empresarios y la sociedad civil, *Colección de educación fiscal*, No. 6, Guatemala City, Latin American Faculty of Social Sciences (FLACSO).
- _____ (2003): *El ocaso de un liderazgo*, Guatemala City, Latin American Faculty of Social Sciences (FLACSO).
- Valdez, F. and M. Palencia (1998): *Los dominios del poder: la encrucijada tributaria*, Guatemala City, Latin American Faculty of Social Sciences (FLACSO).