

negative impact on the living conditions of most citizens, particularly those living in vulnerable situations. This was aggravated late in the year by natural climatic events (i.e., tropical storms ETA and IOTA), which heavily affected rural communities in some of the poorest areas of the country. Despite these challenges and the international context of high uncertainty, Guatemala's macroeconomic fundamentals remain stable. Nevertheless, structural weaknesses like low levels of tax collection persist. Actually, Guatemala has one of the lowest levels of tax collection in the Latin America and Caribbean (LAC) region and the world. The tax-to-GDP ratio has stagnated around 10.4 percent since the end of 2015, well below the 13 percent target foreseen in the tax reform of 2012 and significantly below the LAC average of 16.9 percent. This situation hinders the Government's capacity to increase necessary investment in social programmes and improve the delivery of public services. For instance, government spending on health and education was 5.3% in 2019.

Institutional weakness is certainly a key factor behind the main challenges affecting the country and its population. Years of underinvestment in public services and social and economic infrastructure have led to increased inequalities and gaps in access to public services. The country faces significant challenges to deliver on most of the SDGs. Moreover, poverty and other root causes of high rates of malnutrition in the country need to be addressed. This will come at a significant cost, which will require Guatemala to obtain additional resources and prioritise public investment in these areas. In addition, corruption is another challenge, with Guatemala ranking 149 out of 180 countries in the Corruption Perception Index in 2020.<sup>5</sup> Along this line, the "collect more, spend better" statement in the Consensus sets the path towards strengthening public financial management (PFM) and tax administrations in middle-income countries (MICs) such as Guatemala. The increase of domestic revenue mobilisation (DRM) directly contributes to support macroeconomic and fiscal stability frameworks addressing most of the 5 P's of the Consensus, specifically by providing enough resources for inclusive growth.

In order to achieve this purpose, it is important to tackle the main weaknesses that explain low revenue collection levels. The first one is the low tax compliance culture. For instance, Value Added Tax (VAT) and the Personal Income Tax (PIT) compliance is estimated at only 74 and 20 percent, respectively (in 2019). The second one is the inadequate tax policy framework that has been designed not just to render a low tax burden, but also to steadily reduce the tax burden over time through sunset provisions for specific taxes and excises rates. The regressive nature of the tax system in Guatemala, has also caused a slight increase of poverty (IMF, 2018).

The EU can support Guatemala's efforts to obtain additional revenues to increase public investments in key social areas. It proposes to do so through this action, which lies under Priority Area 3) Good Governance and Human Development of the Multiannual Indicative Programme (MIP) 2021 – 2027. In fact, the proposed action "Effective domestic revenue mobilisation for inclusive growth" aims to increase domestic revenue mobilisation in Guatemala, in order to expand available resources to finance critically needed social investments. Particularly, to help those living in vulnerable situations (i.e., indigenous people, women, the young and persons with disabilities) to overcome social, economic, ethnic and gender inequalities; and to improve public service delivery for the benefit of all Guatemalans.

This overall objective will be achieved by addressing the main weaknesses that cause low revenue collection levels previously described, through three expected outcomes (1) improved voluntary compliance; (2) strengthened governance and transparency of tax administration; and (3) strengthened institutional capacity for revenue mobilisation oversight. Furthermore, the action is framed within the Tax Administration Authority's (SAT) medium-term strategy, which is aligned with the National Development Plan, the Peace Agreements and follows recommendations based upon the Tax Administration Diagnostic Assessment Tool (TADAT). It is also aligned with the United Nations 2030 Agenda for Sustainable Development, directly contributing to achieving SDG 17 "Partnerships for the goals" (especially goal 17.1 Strengthen domestic resource mobilisation, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection). As well as to SDG 1 "End Poverty", SDG 8 "Decent Work and Economic Growth", SDG 5 "Gender Equality", SDG 2 "Zero Hunger" and SDG 10 "Reduced inequalities".

The transformational impact of this action for Guatemala is that enhancing DRM, by promoting a tax compliance culture and improving the efficiency of the tax collection system, will increase fiscal margins to finance public policies in order to address structural social challenges particularly widespread poverty, food insecurity, chronic malnutrition and limited access to health and education, especially for people in vulnerable situations. Moreover,

<sup>5</sup> <https://www.transparency.org/en/countries/guatemala>