The Economic and Fiscal Impact of the Fight Against Corruption in Guatemala

Main Results and Conclusions of the Empirical and Documentary Analysis by ICEFI

Washington DC, August 7th, 2018
1. Motivation
2. Six factors explain the moderation of the Guatemalan economic growth: the fight against corruption is not one of them
4. Conclusions
1. Motivation
Debate: Statements Claiming a *Harmful* Impact

• “What the fight against corruption has brought is an economic slowdown. The economy is a mess.”
  • Francisco Beltranena (Canal Antigua, June 27th, 2018)

• “GDP, foreign investment, bank credit, the main economic variables stalemating... Only migration is increasing... it’s crazy to believe that making the same mistakes will bring different results. No more ‘lawfare’!”
  • José Raúl González Merlo (Tweet, June 27, 2018)

• “The price we’re paying for the so-called fight against corruption has been huge. What is that price? A lack of local and foreign investment.”
  • Carolina Castellanos (República GT, February 9, 2018)

• “Fiscal contraction and the anti-corruption fight: ... the fight against corruption produces economic effects that go beyond the sectors that are directly involved.”
  • Edgar Pape Yalibat (elPeriódico, August 12, 2017)
Debate: Statements Claiming a **Beneficial** Impact

- “Fighting corruption improves a country’s economy and makes it to grow.”
  - Sergio Recinos, Acting President of the Guatemalan Central Bank and Monetary Board
- “The lowering of sovereign ratings...was aggravated by the president’s failed attempt to expel the CICIG commissioner from the country.”
  - Country risk rater Standard & Poor’s
- “A corruption-free economy will bring in more investment, not less.”
- “It should be made clear that Mr. Morales’s war with the CICIG is putting financial aid at risk.”
  - *The Economist* (August 2017)
- “U.S. investments reflect confidence in a Guatemala that fights corruption.”
  - Luis Arreaga, U.S. Ambassador in Guatemala
2. Six factors explain the moderation of the Guatemalan economic growth: the fight against corruption is not one of them
Guatemala’s economy has slowed down

Annual Growth Rate of Real GDP 2014 - 2017

Source: ICEFI, based on Central Bank of Guatemala statistics
Factor 1: Public Spending Austerity

Central government spending is around 13% of the economy (GDP). Budgeting less public spending contributes to the economic slowdown.

Source: ICEFI, based on Ministry of Public Finance statistics
The negative impact on economic growth is even greater if, in addition to a reduced public spending budget, budgetary execution is low.

Source: ICEFI, based on Ministry of Public Finance statistics
Factor 3: Tax Administration’s Inability to Increase Tax Revenue

Despite tax amnesties, tax collection is insufficient for funding more public spending and investment.

Source: ICEFI, based on Ministry of Public Finance statistics
Factor 4: Inflation

Rising prices impact the cost of living with perverse effects on consumption. Consumption is the economy’s main component.

Source: ICEFI, based on Central Bank of Guatemala statistics
Factor 5: The Component of Bank Credit to the Private Sector

- Investors were cautious and demanded less bank credit because of political instability generated by government’s hostile attitude towards fight against corruption.

- Banks preferred buy foreign and T-bonds rather than lend to companies.

Source: ICEFI, based on Superintendence of Banks statistics
Factor 6: Quetzal / US$ Exchange Rate

Fewer quetzals per USD combined with higher prices created disadvantages for items such as exports.

Source: ICEFI, based on Central Bank of Guatemala statistics
The economic slowdown is a regional phenomenon, not just Guatemalan.

• In recent years, economic growth has slowed in all Central American countries, except in Honduras.
  • U.S. economic growth has also slowed since 2015, with an impact on Central America.
• US and Central America as a group are Guatemala’s main trade partners.

The fight against corruption in Guatemala could not possibly slowdown the economic performance of other countries.
Guatemalan Central Bank explains that growth is a result of structural, not short-term factors

- The 2017 *Monetary, Exchange, and Credit Policy Evaluation and Economic Outlook for 2018* published by Guatemalan Central Bank concludes:
  - Capital has not contributed to domestic economic growth for 67 years
  - That is, the low levels of public and private investment are a **structural characteristic** of the Guatemalan economy

- The Guatemalan economic slowdown in 2017 can therefore not be explained solely by short-term factors
  - Such as the fight against corruption and impunity since 2015
From a strictly technical standpoint, is the effect harmful or beneficial?

• Two hypothetical positions can be found in the theoretic economic literature:
  • Corruption is harmful for economic growth and development
  • A little corruption is beneficial: it makes for more efficiency by reducing the costs of bureaucracy and cumbersome red tape

• From an ethical standpoint, ICEFI rejects the second position, considering its arguments irresponsible

• But, ICEFI researched with technical economic rigor the relationship between corruption (or the fight against corruption) and the economy

• The main result is the one dictated by common sense:

**In Guatemala, the fight against corruption is good for economic growth**
How did ICEFI reach this conclusion?

• Using econometric tools applied to:
  • Official data on macroeconomic variables published by Central Bank and the Public Finance Ministry
  • Guatemala’s ranking on the Corruption Perceptions Index (CPI) prepared by Transparency International (TI)

• With this econometric tool, ICEFI analyzed the annual effect over economic growth of the following factors:
  • Corruption, measured by the TI’s CPI
  • Inflation
  • Trade openness (sum of imports and exports)
  • Public spending as % of GDP
  • Population growth
Which factors are significant explaining economic growth?

- The econometric tool revealed:

<table>
<thead>
<tr>
<th>Factor</th>
<th>Significance</th>
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<tbody>
<tr>
<td>Corruption</td>
<td>Significant</td>
</tr>
<tr>
<td>Prices</td>
<td>Not significant</td>
</tr>
<tr>
<td>International trade</td>
<td>Significant</td>
</tr>
<tr>
<td>Public spending</td>
<td>Significant</td>
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<tr>
<td>Population growth</td>
<td>Significant</td>
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In what sense is corruption a significant factor in economic growth?

• Technical econometric analysis reveals:

  In Guatemala, more corruption, less economic growth

• Or, equivalently:

  In Guatemala, more fight against corruption, more economic growth
How does corruption hurt economic growth?

• Then, ICEFI repeated the analysis to study the relationship between corruption and:
  • Current public spending
  • Public and private investment

• In this exercise, ICEFI found that investment is the main transmission channel of the harmful effects of corruption

• That is, the study led to the conclusion that:
  
  **Public and private investment is the most severely harmed by corruption**

• Or, equivalently:
  
  **Investment is the most benefited by fight against corruption**
Moreover, the World Economic Forum points out the negative effect of corruption on competitiveness

- According to the Global Competitiveness Index, Guatemala ranks 84 out of 137 economies (in 2016 ranked 78 out of 138)
- The lowest scores on the Index were obtained in the following pillars:
  - Innovation (3.2/7)
  - Institutions (3.3/7)
- The categories that received the lowest scores under the Institutions pillar were:
  - Ethics and corruption in the public sector (2.6/7)
  - Undue influence in the public sector (3.0/7)
  - Public-sector performance (3.0/7)
  - Security (3.1/7)
  - Corporate ethics (3.5/7)
In the 2017/2018 Global Competitiveness Report, the consulted businesspeople stated that the two most problematic factors (out of 16) for doing business are:

- Crime and theft
- Corruption

Therefore:

**Corruption harms competitiveness**

- The fight against corruption makes people more willing to start a business or invest, which enhances economic growth
4. Conclusions
Conclusions

1. Perhaps, our main finding: **fight against corruption in Guatemala enhances economic activity**

2. Investment, a key factor for economic growth, is the most benefited from fight against corruption

3. Guatemala’s economic growth has indeed slowed, but not because of the fight against corruption
4. Thus, Guatemala’s economic slowdown of 2017 cannot be explained by short-term factors.
   • Such as the fight against corruption and impunity since 2015.

5. The economic slowdown is not an exclusive Guatemalan phenomenon but rather a regional Central American one.
   • The fight against corruption in Guatemala could not slowdown the economic performance of other countries.
Thank you very much!