EL SALVADOR

DOMESTIC RESOURCE MOBILIZATION FOR HEALTH

Mobilizing Tax Revenue and Prioritizing Health Spending in El Salvador – A Case Study

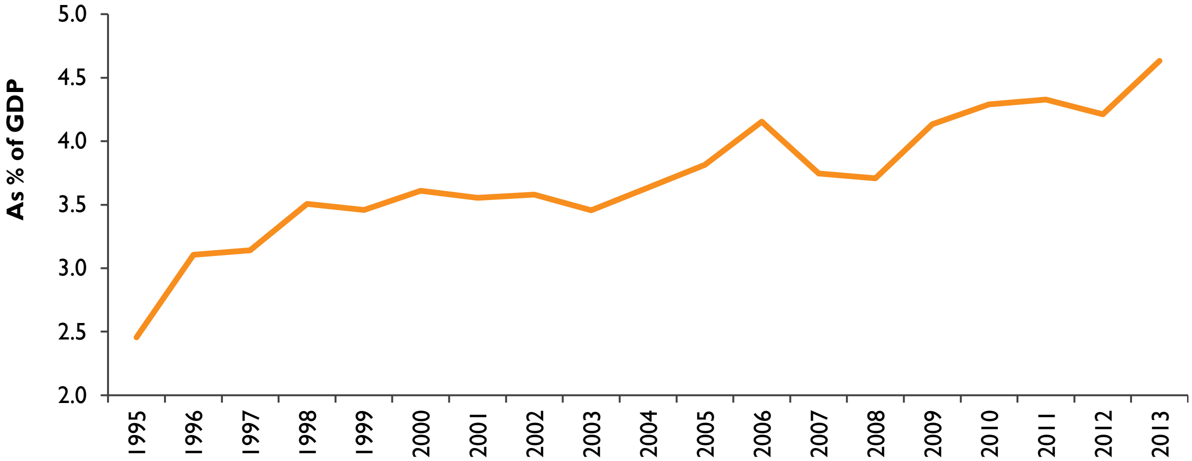
Eunice Heredia-Ortiz, DAI

Introduction

Developing countries around the world are increasingly looking to mobilize tax revenue to finance priority development spending to meet their populations' needs. In this quest, raising more financial resources alone is not enough. Tax reform, even if efficient, will have diminished benefits if it is not accompanied by an equally efficient reform of public expenditure allocation—directing revenue to productive public expenditure programs.

El Salvador provides an important example of a country that underwent tax reform efforts, which boosted revenues to finance key social development programs, including health. Two decades after the end of the civil war and its return to democracy in 1992, El Salvador has achieved important progress in health outcomes, improving life expectancy at birth from 66 years in 1990 to 72 years in 2013, while reducing the under-five mortality rate per 1,000 live births from 59 to 16 in the same period. Accompanying these improvements are the almost doubling of government health spending as percent of GDP from 2.4 in 1995 to 4.6 in 2013 (Figure 1) as well as tax revenue mobilization from less than 8 percent of GDP at the end of the civil war to over 15 percent in 2013.

Figure 1. Government Health Spending (1995–2013)



Sources: Global Health Expenditure Database.

Allocating 18 percent of general government expenditure to the health sector, the Government of El Salvador (GOES) greatly surpasses the average for Latin American countries, which was 10 percent in 2013, and reaches the average for OECD countries. While El Salvador's tax-to-GDP ratio of 15.4 percent in 2013 is low compared to the region's average of 21.3 percent, El Salvador has been recognized among the countries with the largest increases in tax-to-GDP ratios (OECD 2015). Meanwhile, the GOES continues to strive to reach its revenue mobilization targets while maintaining its commitment to greater social spending.

The rest of this case study provides a review and analysis of tax policy and administration reforms introduced in El Salvador in the past two decades, the resulting tax revenue mobilization, and the impact on government health spending.

What Contributed to the Prioritization of Public Health Spending?

Following an expected increase in government health spending immediately after the civil war, government health spending as percent of GDP stagnated in El Salvador until 2003. What happened in the last decade that caused this trend to turn?

Introducing key health initiatives since the mid-2000s, the GOES put greater emphasis on inclusive growth and poverty reduction, including improving access to and quality of key social services such as health and education. As part of the 2004-2009 development plan (**Plan País Seguro**), the government launched its "*Plan de Oportunidades*" (Opportunities Plan) aimed at improving the quality and coverage of social services in the country's hundred poorest municipalities.

Two of the five priorities in this initiative relate to improving health services, including: (1) FOSALUD—focused on increasing the set of medical services available in local health units; and (2) an innovative sub-program "Redes Solidaridad"—focused on improving access to and quality of social services to the poorest municipalities. The same administration promulgated the 2007 Law for the Creation of the National Health System, which looked to expand coverage, reduce health inequalities, and improve the coordination of government health institutions.

Building upon prior efforts, between 2009 and 2014, the GOES launched a more comprehensive and longer-term health strategy, the **National Health Policy 2009-2014** (Figure 2), marking a new era for the health sector (DSW 2011). Eight priority areas make up this national health initiative, with the stated objective of building a more integrated national health system that improves access, efficiency, and quality of health services.

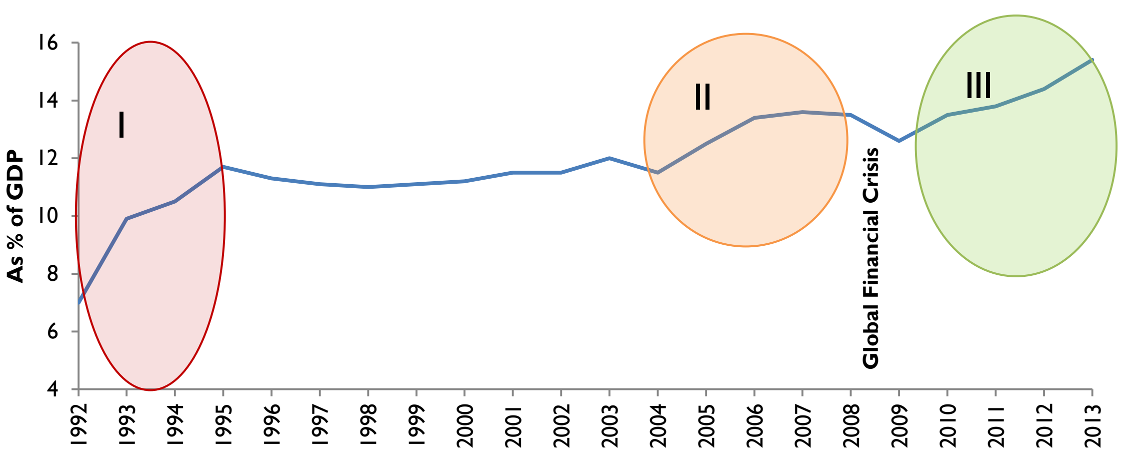
Figure 2. El Salvador's National Health Policy (2009–2014)

Furthermore, ten priority actions were launched that included abolishing user fees for health, extending access to impoverished rural communities, stocking essential medicines and basic medical supplies in all government health facilities, and reorganizing the entire government health sector (MSPAS, ISSS, FOSALUD)[1] to tackle the severe fragmentation in health services.

Supporting the National Health Policy, El Salvador's **2010-2014 National Development Plan** (*Plan Quinquenial*) and the **Anti-Crisis Plan**, which followed the global crisis, prioritized health financing in support of a broader universal social sector policy, which also includes nutrition, education, and housing services delivered through "*Comunidades Solidarias*." By 2013, 164 of the 262 municipalities in the country had benefitted from the reform program, expanding access to basic health services to 1.9 million Salvadorans from the poorest and rural municipalities (MINSAL 2013).

All of these health initiatives required increases in government health spending both in absolute and in per capita terms. How did the GOES mobilize the resources needed?

Figure 3. The Effect of 3 Rounds of Tax Reforms on El Salvador's Tax Revenue (1992–2013)



Source: Tax Analysis Unit, DGII, Ministry of Finance, El Salvador.

[1] In El Salvador, public health and social insurance are combined with public, private and community health services, creating a very stratified system. Public providers include the Social Security Institute (ISSS), the Military Health, and the Teachers Welfare Institute (BM) which cover their own closed populations (ca. 18% of the population). The Ministry of Public Health and Social Assistance (MPSAS) and the Social Solidarity Health Fund (FOSALUD) are responsible for the rest of the population (ca. 66%), although in practice they do not have complete coverage (USAID 2009).

Mobilizing Tax Revenue: Overview of Key Tax Reforms

El Salvador made three major tax reform efforts over the past two decades (Table 1). The first reform began in the early 1990s following the conclusion of the civil war. During this period, the GOES introduced a number of tax and trade policy reforms, as well as reforms to widen the tax base, which included replacing the cascading sales tax with a value-added tax (VAT). These changes were complemented with modernization efforts in tax and customs operations, such as the automation of internal procedures. Between 1992 and 1994, tax revenue as a percent of GDP rose from 7 to 11 percent (See Figure 3).

After a decade of stagnant tax revenue performance, the second reform began in the mid-2000s with support from external technical assistance in design and implementation (USAID 2008). This reform primarily focused on improving tax administration, and during this period, the General Internal Revenue Department (DGII) introduced measures to improve fiscal compliance, mitigate fraud and corruption, and increase the efficiency of administrative processes. These reforms contributed to increasing the tax-to-GDP ratio by nearly 2 percentage points to about 13 percent (Figure 3).

Table 1. Overview of Key Tax Policy and Administration Reforms in El Salvador

	Tax Policy Reforms		Tax Administration Reforms	
Mid-1990s to 2000	Tax and Trade Reforms	• Repealed export tax on coffee, stamp taxes, and taxes on documents • Revised import duty schedule • Lifted zero-rated imports	Modernization of tax and customs operations	• Automated internal procedures • Introduced the Automated Systems for Customs Data (AYSCUDA) • Enhanced audit procedures
	Revenue Generation	• Introduced VAT		
	Rationalization	• Rationalized personal and corporate income taxes while reducing tax rates		
Mid-2000s	Revenue Generation	• Required legal entities and professionals to make estimated tax payments (*pago a cuenta*)	Modernization	• Created Large Taxpayer Unit • Introduced risk-based audit • Modernized IT infrastructure • Targeted fraud and corruption • Strengthened strategic planning and tax analysis • Introduced anti-transfer pricing techniques • Established the Fiscal Compliance Division and Call Center • Launched the Case Selection Management System (CSMS) to automate audit processes and procedures • Enhanced taxpayer service: introduced taxpayer advocacy unit and taxpayer assistance call center
	Improving Tax Compliance	• Required large taxpayers to withhold 1% of VAT to small and medium taxpayers		
Late 2000s to 2015	Revenue Generation	• Raised marginal income tax and some excise rates • Eliminated exemptions in 2010 and 2012 • Introduced a tax on bank transfers for amounts >$1,000 • Implemented minimum payment of 1% of income tax on net assets • Updated tax code	Modernization	• Cleansed the taxpayer registry • Tackled tax arrears by establishing a treasury collections call center • Expanded case selection management system (CSMS II) for multiple audit campaigns • Integrated customs information with internal revenue to improve the risk methodology and audit productivity • Improved taxpayer service through automated self-service kiosks

Source: Author's summary from various sources including USAID 2008, 2014, 2015, and Ministry of Finance, El Salvador. DGII, El Salvador.

The third reform, which began in 2012, included a package of progressive tax modifications including raising the income tax rate and some excise tax rates, and eliminating exemptions in two phases. This was accompanied by a number of initiatives to modernize the tax administration system, such as enhancing taxpayer service and improving audit productivity. These reforms brought the tax-to-GDP ratio to 15.4 percent (Figure 3).

Tax Revenue Mobilization Results

El Salvador achieved important progress in mobilizing tax revenue in the past decade. Tax revenue increased from 11.5 percent of GDP in 2004 to 15.4 percent in 2013—nearly a 4 percentage point increase—achieving a consistent growth trend since 2010. Up until 2012, El Salvador achieved significant tax revenue mobilization without raising tax rates. The expansion of tax revenue collections in 2012 and 2013 was achieved despite sluggish economic growth and while decreasing taxes on trade due to trade liberalization.

Taxes from VAT continue to be the largest component of tax revenue, representing nearly half of collections (Figure 4). Nevertheless, taxes from income and profits have been consistently increasing and growing by 80 percent since 2004, including a sharp increase after the introduction of the tax reform package in 2012.

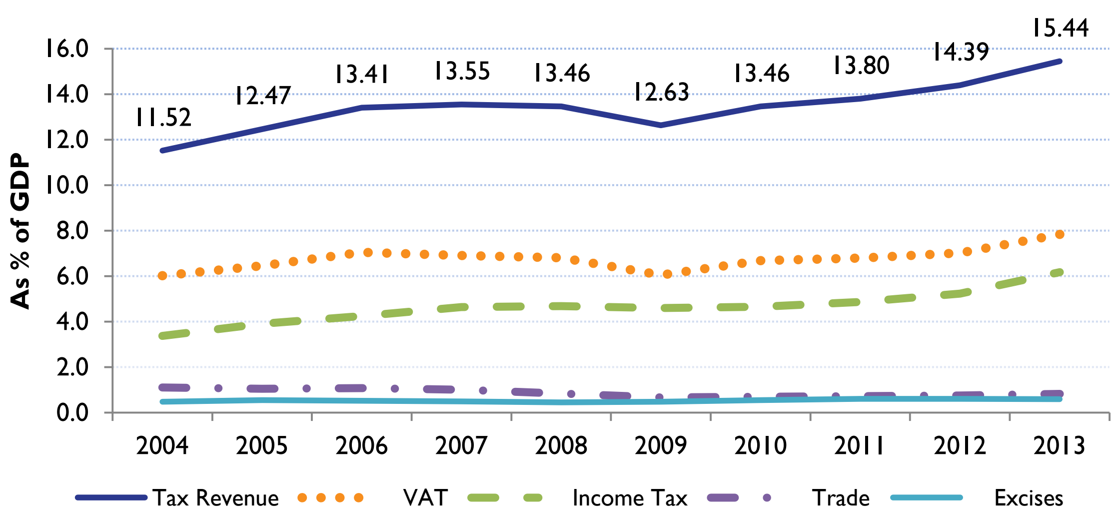
With respect to other tax performance measures (Table 2), performance indicators show persistent and important improvement. The VAT Gross Compliance Ratio (VATGCR) measures how well the VAT performs in terms of producing tax revenue. VATGCR is measured by dividing VAT revenue by total private consumption in the economy and then dividing that figure by the VAT rate. The VATGCR for El Salvador during the period indicates base broadening in terms of improved compliance brought about by tax administration strengthening. The VAT revenue productivity, a measure of the amount of VAT tax revenue collected given its rate structure (calculated as the ratio of VAT revenue to GDP divided by the standard VAT rate) also shows improvement over time. In 2013 a one percentage point of VAT collects 0.52 percent of GDP, which is higher than the average for Latin America of 0.46 percent. Furthermore, major efforts for lowering compliance and administrative costs are reflected in the measure of the electronic filing rate of large taxpayers, reaching nearly 60 percent since efforts began in 2005.

Table 2. El Salvador Tax Performance Indicators (2004–2013)

Performance Indicator	2004	2007	2010	2013
VAT Gross Compliance (%)	51	55	55	59
VAT Productivity	.47	.53	.56	.52
Large Taxpayers e-filing rate (%)	0	20.0	48.9	59.0

Source: Ministry of Finance, El Salvador and USAID's Collecting Taxes Database 2008-2013.

Figure 4. Tax Revenue, by Type of Tax (2004–2013)

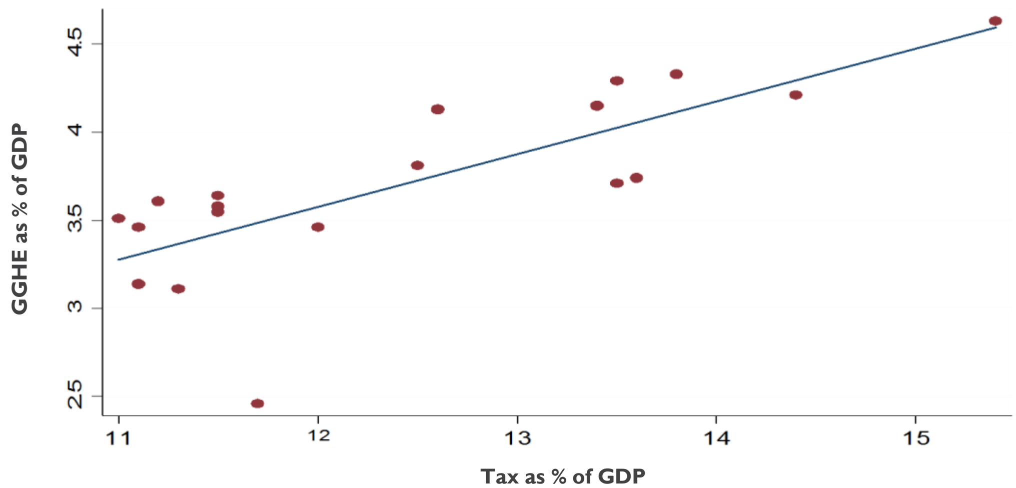


Source: General Internal Revenue Department (DGII), Ministry of Finance, El Salvador.

Impact on Health Financing

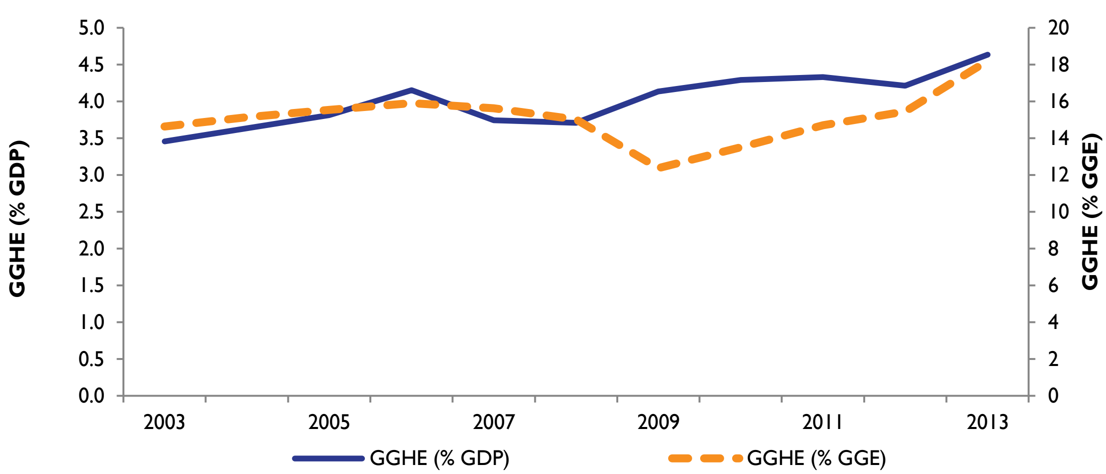
Analysis of the relationship between tax revenue (as percent of GDP) and government health spending in El Salvador over the past 20 years demonstrates a positive relationship between these two—as the value of tax revenue to GDP rose so did the value of government health spending (Figure 5). This trend likely reflects an increase in the government's fiscal space combined with political prioritization of health.

Figure 5. Tax Revenue Mobilization and Government Health Spending (1995–2013)



The result of political support for increased health spending during 2003-2013 is palpable as the share of government spending on health rose as a proportion of general government expenditures and GDP. Figure 6 displays how the proportion of general government health expenditure (GGHE) in the overall budget (GGE) dipped from about 16 percent (2003-2007) to 12 percent (2009) but then increased to over 18 percent (2013).

Figure 6. General Government Health Spending (2003–2013)

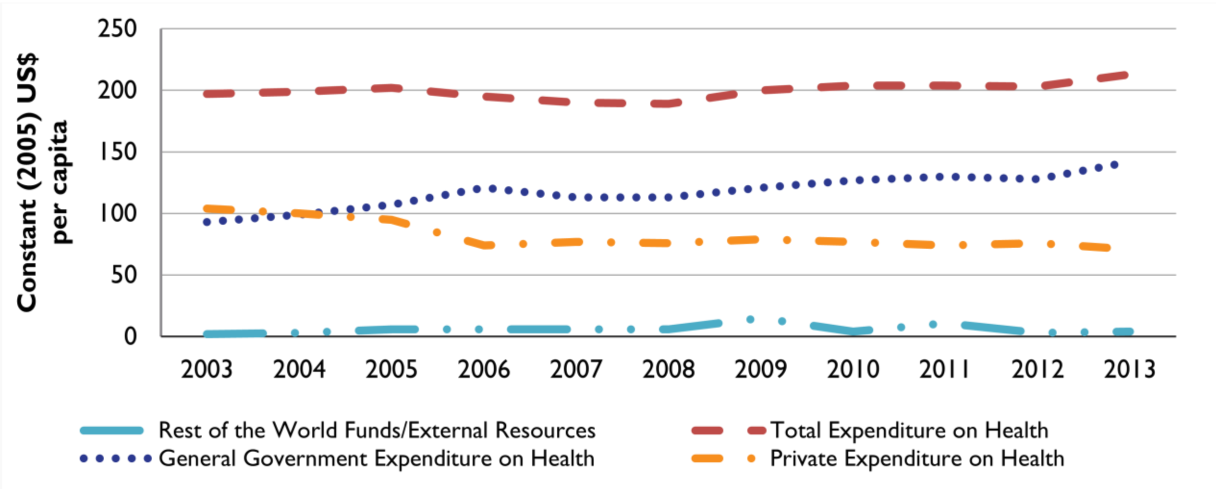


Source: WHO's Global Health Expenditure Database, Ministry of Finance, El Salvador. DGII, El Salvador

El Salvador's health spending as a share of GGE exceeded the Latin America regional average of 9.7 percent over the period 2005-2013[2] and 10.1 percent in 2013. This demonstrates the political commitment of the GOES to health spending in the last decade.

In addition to the health gains cited in the introduction to this case study, the increase in GOES health spending reduced out-of-pocket (OOP) expenditure (Figure 7). OOP spending per capita decreased by 40 percent from near $100 in 2003 to $61 in 2013, while GOES health spending increased from $93 in 2003 to $142 per capita in 2013.

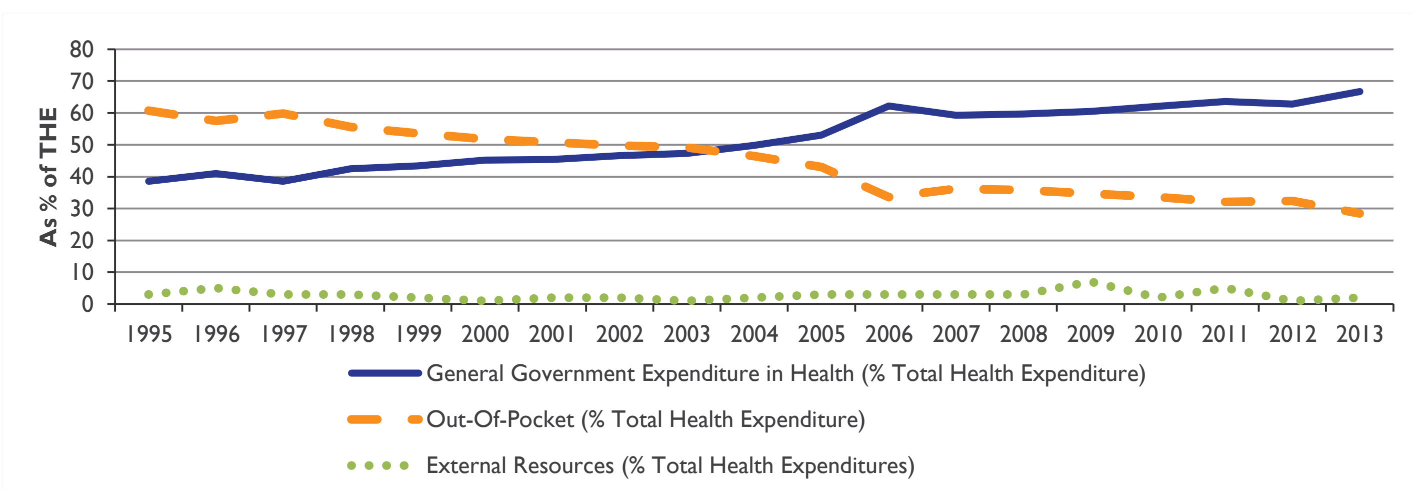
Figure 7. Trends in Health Expenditure per capita (2003–2013)



Source: WHO's Global Health Expenditure Database and DGII, Ministry of Finance, El Salvador.

Figure 8 shows that government health spending increased as a share of total health spending (THE) from less than 40 percent in 1995 to 67 percent in 2013. This relieved the burden of OOP spending so that it fell from more than 60 percent to less than 30 percent of total health spending in the same period.

Figure 8. Sources of Health Financing (2003–2013)



Source: WHO's Global Health Expenditure Database and DGII, Ministry of Finance, El Salvador.

[2] Author's calculation based on regional data from the WHO's Global Health Expenditure Database

Conclusion

El Salvador is an important example of a country that has made health a national political priority, when greater public resources were achieved through tax reform. Looking ahead, the GOES plans to sequence tax reform with important public expenditure management reform initiatives. The implementation of a multi-year, results-based budget, for example, is expected to give greater focus to investing public resources linked to the achievement of specific health targets and outcomes. Sustaining accomplishments thus far in tax revenue mobilization will facilitate maintaining the GOES' achievements in key sectors such as health.

Photo credits:
First page: Courtesy of Photoshare
Page 2: © 2001 Jim Stipe, Courtesy of Photoshare
Back page: © 2001 Alfredo L. Fort, Courtesy of Photoshare

References

DSW (2011), Health Spending in El Salvador: The Impact of Current Aid Structures and Aid Effectiveness, Action for Global Health, German Foundation for World Population (DSW). *EU Health ODA and Aid Effectiveness*, Country Briefing 3, February 2011.

FUSADES (2013), Análisis de la política publica de salud en El Salvador, Departamento de Estudios Sociales DES, Fundación Salvadoreña para el Desarrollo, FUSADES.

MINSAL (2013), Accountability Report 2012-2013, Ministry of Health, Government of El Salvador, August 14, 2013.

OECD (2015), Revenue Statistics in Latin America and the Caribbean 2015, OECD Publishing, Paris.

USAID (2008), Documento de Politica Fiscal para El Salvador, June.

USAID (2009), El Salvador: Health Sector Needs Assessment. (No. 08-001-150). Washington D.C.

USAID (2010), El Salvador Tax Policy and Administration Reform Program (TPAR): Fifth Year Evaluation Report.

USAID (2014), El Salvador Fiscal Policy and Expenditure Management Program (FPEMP): Third Year Evaluation Report, June 2013 – June 2014."

USAID (2015), El Salvador Fiscal Policy and Expenditure Management Program (FPEMP): Fourth Year Evaluation Report, June 2014 – June 2015."

World Health Organization's Global Health Expenditure Database, available online at: http://www.who.int/health-accounts/ghed/en/

The Health Finance and Governance (HFG) project works with partner countries to increase their domestic resources for health, manage those precious resources more effectively, and make wise purchasing decisions. Designed to fundamentally strengthen health systems, the HFG project improves health outcomes in partner countries by expanding people's access to health care, especially to priority health services. The HFG project is a five-year (2012-2017), $209 million global project funded by the U.S. Agency for International Development under Cooperative Agreement No: AID-OAA-A-12-00080.

The HFG project is led by Abt Associates in collaboration with Avenir Health, Broad Branch Associates, Development Alternatives Inc., Johns Hopkins Bloomberg School of Public Health, Results for Development Institute, RTI International, Training Resources Group, Inc.

For more information visit www.hfgproject.org/

Agreement Officer Representative Team: Scott Stewart (sstewart@usaid.gov) and Jodi Charles (jcharles@usaid.gov).

Abt Associates
4550 Montgomery Avenue
Suite 800 North
Bethesda, MD 20814
www.abtassociates.com

October 2015