

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**GUATEMALA**

**THE BANK'S COUNTRY STRATEGY  
WITH GUATEMALA 2012-2016**

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This document was prepared by the team consisting of: Olga Gómez García (CID/CID), Edna Armendariz (CID/CID), Alejandro M. Fros (CID/CGU), Naiara Martínez (CID/CID), Laura Alonso (CID/CID), Mauricio López Prada (CID/CID), and Juan José Taccone (CSC/CUR); with input from Adela Arreaga (CID/CGU), René Cortés (INE/TSP), María Cecilia del Puerto (PDP/CGU), Armando Godinez (EDU/CGU), Claudia González (ICS/CGU), Sergio Lacambra (INE/RND), José I. Larios (FMM/CGU), Luis Larrazabal (CID/CGU), Juan Manuel Leño (TSP/CPN), Ian MacArthur (SPH/CGU), Pedro Martel (RND/CGU), Juan de Dios Mattos (RND/CGU), Roberto de Michele (CMF/CGU), Manuel José Navarrete (WSA/CGU), Yasmin Portillo (FMM/CGU), Jorge Omar Samayoa (CCS/CGU), Benjamín Santa María (ICS/CGU), Jaime Silva (ECC/CGU), Marco Stampini (SCL/SPH), Anne-Marie Urban (GDI/GDI), Hugo Us (GDI/CGU), Oscar Vielman (CID/CGU), Karelía Villa (ICF/ICS), and José Villatoro (PDP/CGU).

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## ABBREVIATIONS

AECID	Agencia Española de Cooperación Internacional para el Desarrollo [Spanish Agency for International Development Cooperation]
BANGUAT	Banco Central de Guatemala [Central Bank of Guatemala]
CABEI	Central American Bank for Economic Integration
CIAT	Inter-American Center of Tax Administrations
ECLAC	Economic Commission for Latin America and the Caribbean
ENCOVI	Living Standards Survey
ENEI	National Employment and Income Survey
ENSMI	National Maternal and Child Health Survey
FAO	Food and Agriculture Organization
FIS	Fondo de Inversión Social [Social Investment Fund]
GDP	Gross domestic product
GDPRD	Global Donor Platform for Rural Development
IFAD	International Fund for Agricultural Development
IMCI	Integrated Management of Childhood Illness
INE	Instituto Nacional de Estadística [National Statistics Institute]
INFOM	Instituto de Fomento Municipal [Municipal Development Institute]
MBS	<i>Mi Bono Seguro</i> social assistance program
MFMP	Marco Fiscal de Mediano Plazo [Medium-term Fiscal Framework]
MINFIN	Ministry of Public Finance
MSE	Micro and small enterprises
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
PNC	Policía Nacional Civil [National Civil Police]
SAT	Superintendencia de Administración Tributaria [Superintendency of Tax Administration]
SEGEPLAN	Secretaría General de Planificación y Programación de la Presidencia [Planning and Programming Secretariat, Office of the President of Guatemala]
SIAF	Sistema Integrado de Administración Financiera [Integrated Financial Administration System]
SNIP	Sistema Nacional de Inversión Pública [National Public Investment System]
TFFP	Trade Finance Facilitation Program
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
UNIFEM	United Nations Development Fund for Women
UNODC	United Nations Office on Drugs and Crime
WB	World Bank
WFP	World Food Programme
WHO	World Health Organization

## EXECUTIVE SUMMARY<sup>1</sup>

<b>Country context:</b>	Guatemala's economic growth has been moderate in recent years, and GDP per capita has stagnated. At the same time, poverty has increased and the disparities between rural and urban areas have remained. These disparities arise primarily from differences in: (i) access to health and education services; (ii) infrastructure; and (iii) opportunities for income generation. There are also three constraints on development at the national level: the institutional framework, the fiscal framework, and ethnic and gender inequity.
<b>The IDB in Guatemala:</b>	The IDB is the country's main source of external finance and one of the main providers of technical assistance. The main areas of Bank support have been fiscal and municipal (20.0%), social protection (17.7%), financial and capital market development (11.6%), and transportation (10.3%).
<b>The 2012-2016 strategy:</b>	The Bank's country strategy with Guatemala 2012-2016 focuses on improving living conditions for the Guatemalan population, particularly those living in rural areas. The strategy's priority target areas are structured along two axes, the first institutional, covering the areas of (i) fiscal and municipal management, (ii) social protection, and (ii) peaceful coexistence and citizen security; and the second addressing rural development, including the areas of (iv) productive development, (v) health, and (vi) transportation. Work will also be done in the crosscutting areas of climate change adaptation and mitigation, natural disaster impact mitigation, indigenous peoples and gender; and regional integration will be promoted, particularly in the transportation and energy sectors.
<b>Lending framework:</b>	The Bank is considering two scenarios for sovereign guaranteed lending. The base scenario entails approvals of US\$740 million over the strategy period, and the high scenario US\$900 million.
<b>Strategy implementation:</b>	The IDB will adopt a dual approach to country strategy implementation: (a) a sector approach for the institutional axis, and (b) a territorial, integrated, multisector, and community-focused approach for the rural development axis. The country's needs will be met through a combination of instruments and effective scaling of projects. The IDB will continue strengthening the design, execution, and monitoring of its programs and will frontload approvals in the early years of the strategy. Progress will continue in the use of country systems. The strategy has

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<sup>1</sup> This country strategy will be in effect from the time of its approval by the Board of Executive Directors through December 2016.

been developed in close collaboration with the World Bank, and this partnership will continue during the implementation phase.

**Risks:**

The main risk faced by the strategy is potential delay in the execution of investment projects. A variety of actions are envisaged to mitigate this risk, including (i) simplify operation design (i.e. scale, mode of execution, and identification of suitable execution units), (ii) synchronize interventions with the national budgeting and planning cycle; and (iii) work with the government to build the technical capacity of execution units.

## RESULTS FRAMEWORK<sup>2</sup>

IDB Strategy areas	Priority sectors	IDB strategic objectives	Expected outcomes of the strategy	Indicator	Baseline	Indicative target
Fiscal and municipal management	Fiscal and municipal management	Improve the pattern of taxation	Law on Payment of Tax Arrears implemented	Law on Payment of Tax Arrears regulated and implemented	Law on Payment of Tax Arrears neither regulated nor implemented 0 <i>Base: 2011</i> <i>Source: Ministry of Public Finance (MINFIN)</i>	Law on Payment of Tax Arrears regulated and implemented 1 <i>Target: 2016</i> <i>Source: MINFIN</i>
		Improve budget planning and execution capacity	Medium-term Fiscal Framework (MFMP) developed <sup>3</sup>	Multiyear budget with MFMP	Multiyear budget 2012-2014 (not including MFMP) 0 <i>Base: 2011</i> <i>Source: MINFIN</i>	Multiyear budget 2016-2017 (including MFMP) 1 <i>Target: 2016</i> <i>Source: MINFIN</i>
		Strengthen the fiscal capacity of municipalities	Financial strength of municipalities improves	Ratio of total municipal debt to own revenues	94% <i>Base: 2009</i> <i>Source: MINFIN</i>	85% <i>Base: 2016</i> <i>Source: MINFIN</i>

<sup>2</sup> The targets are indicative will be revised or replaced, as the case may be, through the country programming documents to be developed during the country strategy period.

<sup>3</sup> The Medium-term Fiscal Framework is a fiscal planning and financial management instrument with a 3- to 4-year outlook. It is used to determine public income and expenditure, as well as financing alternatives. This instrument helps to improve the process of budget programming, management of countercyclical policies, and fiscal sustainability.



IDB Strategy areas	Priority sectors	IDB Strategic objectives	Expected outcomes of the strategy	Indicator	Baseline	Indicative target
Social protection	Social protection	Improve the targeting and target population coverage of social protection programs	The targeting and target population coverage of social protection programs improves	Percentage of households living in extreme poverty included in the <i>Mi Bono Seguro</i> (MBS) program <sup>4</sup>	51.9% <i>Base: 2011</i> <i>Source: ENCOVI 2011</i>	60.0% <i>Target: 2016</i>
			Less leakage of social protection programs	Percentage of nonpoor homes included in the MBS program	23.5% <i>Base: 2011</i> <i>Source: ENCOVI 2011</i>	20.0% <i>Target: 2016</i>
			Expanded coverage (% receiving transfers) of MBS program among indigenous households living in extreme poverty	Percentage of indigenous people living in extreme poverty receiving MBS program transfers	57.2% <i>Base: 2011</i> <i>Source: ENCOVI 2011</i>	65% <i>Target: 2016</i>

<sup>4</sup> The *Mi Bono Seguro* program accounts for approximately 90% of social assistance benefits.

Peaceful coexistence and citizen security	Peaceful coexistence and citizen security	Strengthen the National Civil Police (PNC) institutionally in such areas as career policing, personnel training, and control of police misconduct	A stable cadre of officers established in sufficient numbers to supervise the work of subordinates	Number of managers/Total number of police	9.7% <i>Base: 2011</i>  <i>Source: Police Reform Commission</i>	28.0%  <i>Target: 2016</i>
		Improve the quality and results of criminal investigations	A greater percentage of cases handled by the Public Prosecutor's Office (MP) result in a judgment.	Number of complaints resulting in a judgment/Number of complaints received by the MP in a year.	1.13% <i>Base: 2010</i> <i>Source: Public Prosecutor's Office (MP)</i>	1.63% <i>Target: 2016</i>
			A greater percentage of homicides are solved.	Number of murders leading to a conviction in a year/Total number of murders reported in a year	3.40% <i>Base: 2010</i> <i>Source: Public Prosecutor's Office (MP) and Justice Agency (OJ)</i>	4.25% <i>Target: 2016</i>
		Reduce the vulnerability of women and young people to violence and crime	A smaller percentage of women have suffered violence at the hands of their partner or ex-partner	Percentage of women aged 15 to 49 who have suffered some form of violence at the hands of their partner or ex-partner in the last 12 months	23.4% <i>Base: 2009</i> <i>Source: ENSMI 2008/9</i>	20.0% <i>Target: 2016</i>
			Victimization of young people aged 16 to 27 decreases	Percentage of young people between 18 and 29 who are victims of a crime	25.1% <i>Base: 2010</i> <i>Source: Latin American Public Opinion Project (LAPOP)</i>	21.3% <i>Target: 2016</i>

Rural development	Productive development <sup>5</sup>	Create opportunities to improve incomes from productive activities for the rural population	Income of rural households below the poverty line increases	Monthly income per capita from productive activities for rural inhabitants below the poverty line	Q 700.4 <i>Base: 2012</i> <i>Source: ENCOVI 2011</i>	Increase of +10% in real terms since the base year  <i>Target: 2016</i>
				Rate of annual income growth from productive activities for rural indigenous households (excludes remittances and transfers)	0%  <i>Base: 2011</i>  <i>Source: ENCOVI 2011</i>	Increase of at least +15% in real terms since the base year  <i>Target: 2016</i>
		Diversify sources of income of rural households	Nonfarm rural incomes increase	Monthly income per capita from nonfarm productive activities for rural inhabitants below the poverty line	Q 411.7  <i>Base: 2011</i> <i>Source: ENCOVI 2011</i>	Increase of 15% in real terms since the base year  <i>Target: 2016</i>

<sup>5</sup> In the context of this country strategy, productive development is defined as the set of actions intended to promote the creation, spread, consolidation, and/or growth of the business fabric.

	<b>Health</b>	Reduce under-5 chronic undernourishment in rural areas	The under-5 chronic undernourishment rate (height for age, 3 to 59 months) is reduced in rural areas	Child chronic undernourishment rate (height for age, 3 to 59 months) – Rural	58.6% <i>Base: 2009</i> <i>Source: National Maternal and Child Health Survey (ENSMI) 2008/9</i>	48.5% <i>Target: 2016</i>
		Reduce child mortality in rural areas	The child mortality rate is reduced in rural areas	Child mortality rate (per 1,000 live births) – Rural	38 <i>Base: 2009</i> <i>Source: ENSMI, 2008-2009</i>	34 <i>Target: 2016</i>
		Improve maternal health in rural areas	Maternal mortality is reduced in the rural population	Percentage of institutional deliveries in rural areas at a health care facility	36.4% <i>Base: 2009</i> <i>Source: ENSMI, 2008-2009</i>	46.4% <i>Target: 2016</i>
				Percentage of institutional deliveries by indigenous women in rural areas at a health care facility	29.2% <i>Base: 2009</i> <i>Source: ENSMI, 2008-2009</i>	37.5% <i>Target: 2016</i>
			The prevalence of overweight and obesity among women aged 15 to 49 is reduced in rural areas	Percentage of overweight or obese women aged 15 to 49 in rural areas	45.5% <i>Base: 2009</i> <i>Source: Martorell, 2012.</i>	43.5% <i>Target: 2016</i>

	<b>Transportation</b>	Expand the rural road system	The number of km of rural roads increases	Number of km of rural roads	4,100 km <i>Base: 2012</i> <i>Source: Ministry of Communications, Infrastructure and Housing (MCIV)</i>	4,600 km <i>Target: 2016</i>  <i>Source: MCIV</i>
		Improve the infrastructure quality of the rural road system	The levels of permanent rural road serviceability <sup>6</sup> improve	Permanent serviceability rate in the target areas	<i>Baseline: TBD</i>  <i>Base: 2013</i>	+25%  <i>Target: 2016</i>

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<sup>6</sup> Serviceability: Traffic can circulate on the road at all times, free from obstructions that interrupt traffic flow. Serviceability rate: Percentage of days in a year when the road is serviceable.

<b>IDB Strategy area</b>	<b>IDB Strategic objective</b>	<b>Expected outcomes during the strategy</b>	<b>Baseline</b>	<b>Target</b>
<b>Financial management and public procurement</b>	<b>Strengthen Guatemala's Financial Information and Administration System (SIAF)</b>	SIAF enables financial administration of Bank-financed operations in the country complying with budget management, cash management, accounting, and reporting requirements.	SIAF is not used formally as the sole project financial management tool.	SIAF is 100% accepted and used as a project financial management tool.
	<b>Improve the efficiency of financial management</b>	The costs of financial supervision are lowered.	To be established on or after 31 December 2012.	Supervision costs are lowered by 50%.
	<b>Improve the investment quality of Bank-financed projects</b>	A system is implemented to measure the investment quality of projects.	No measurements are taken.	100% of projects in execution measure investment quality: unit cost and destination of investment.
	<b>Improve transparency and competitiveness of procurement processes</b>	The shopping subsystem is used in the sovereign guaranteed loan portfolio.	(a) Diagnostic assessment of the electronic subsystem.  (b) Percentage of the portfolio that uses the shopping subsystem.	(a) 100% of the diagnostic assessment's recommendations are implemented.  (b) 20% of the portfolio uses the shopping subsystem.

## I. COUNTRY CONTEXT

- 1.1 Guatemala has experienced moderate growth in recent years.<sup>7</sup> In a context of high population growth rates, this has led to stagnation in GDP per capita. At the same time, the inequality index has held constant,<sup>8</sup> the incidence of poverty has risen from 51.0% of the population in 2006 to 53.7% in 2011, and extreme poverty has declined from 15.2% in 2006 to 13.2% in 2011.
- 1.2 These poverty averages conceal great disparities between rural and urban areas. A disaggregated analysis shows that extreme poverty rates in rural areas (21.1%) are four times higher than in urban areas (5.1%), and that the overall poverty rate in rural areas (71.3%) is twice that of urban areas (35.0%). The progress made over the last decade, in terms of human capital and access to basic services in urban areas, has barely permeated rural areas. What is more, economic opportunities and job creation in rural areas remain very limited.<sup>9</sup>
- 1.3 These disparities, as identified by the “Growth Diagnostic Study” on Guatemala and the various sector studies conducted during preparation of the Bank’s country strategy with Guatemala, are due primarily to two factors: (i) the limitations in terms of access to basic health and education services (affecting human capital) and (ii) major infrastructure lags in rural areas.
- 1.4 There are also two constraints affecting the country as a whole: the institutional framework and the fiscal framework. Specifically, in terms of institutions, violence and the lack of citizen security have been identified as the main obstacles to investment<sup>10</sup> and the creation of greater opportunities to improve the country’s levels of human development.<sup>11</sup> Other factors under this heading include impunity, lack of transparency, accountability, and the bureaucracy involved in doing business.
- 1.5 The government’s limited revenue collection capacity constrains the State’s ability to meet these challenges. Indeed, despite the enactment of a Law on Payment of Tax Arrears, Guatemala’s ratio of tax revenue to GDP remains among

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<sup>7</sup> Average GDP growth from 2008 to 2011 was 2.7%.

<sup>8</sup> With a Gini coefficient of income of 54%, Guatemala is the most unequal country in Latin America.

<sup>9</sup> Echeverría, R.G.; “Opciones para reducir la pobreza rural en América Latina y el Caribe” [Options for rural poverty reduction in Latin America and the Caribbean], *Revista CEPAL* 70, 2000; and Auguste, S. and Bebczuk, R; “Acceso al financiamiento y mitigación de riesgos en el sector rural en Guatemala: Diagnóstico y recomendaciones” [Access to finance and risk mitigation in rural Guatemala: Diagnostic assessment and recommendations], 2012.

<sup>10</sup> The results of the Enterprise survey (International Finance Corporation of the World Bank, 2010) puts crime at the top of the ten most important constraints on the business climate identified by companies.

<sup>11</sup> Violence and citizen insecurity take a heavy toll on human capital and carry a cost for the country (health care expenditures, loss of production, higher insurance premiums, etc.) of around 7.7% of GDP. Source: World Bank, “Crime and violence in Central America,” 2011.

the lowest in LAC,<sup>12</sup> and the need persists to raise tax revenues and expand the tax base. The segmentation of responsibilities for budget formulation and execution, challenges of transparency, rigidities of expenditure allocation in the General Income and Expenditure Budget,<sup>13</sup> and the imperfect fiscal decentralization framework restrict the government's capacity to implement public programs, and distorts the efficient allocation of the limited resources available.

- 1.6 These needs will increase in the coming years, as the impact of climate change is expected to intensify,<sup>14</sup> with repercussions for infrastructure maintenance, river flows (and hence power generation), agricultural production patterns, and the state of habitability of dwellings. Guatemala also faces serious challenges in terms of ethnic and gender<sup>15</sup> equity,<sup>16</sup> a fact that is clear from poverty levels, access to education, political representation, and many other factors. The poverty and extreme poverty rates among the indigenous population are 73.4% and 22.3%, respectively,<sup>17</sup> considerably higher than the national average. Moreover, indigenous women have an average of 2.5 years of schooling, compared with 4.6 years for indigenous men, 6.7 years for nonindigenous women, and 7.5 years for nonindigenous men.<sup>18</sup> In the political sphere, the Congress of the Republic of Guatemala, which is the country's only chamber of representatives, has 19 deputies of indigenous origin<sup>19</sup> (12% of the total seats)<sup>20</sup> and 13 women deputies (8.2% of the total).<sup>21</sup> These disparities are holding the country back significantly in terms of human development.<sup>22</sup>

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<sup>12</sup> Of the group of LAC countries, only Haiti has a lower tax burden than Guatemala. Source: IMF, "World Economic Outlook Database, April 2012."

<sup>13</sup> 88.9% of the spending in the General Income and Expenditure Budget is rigid.

<sup>14</sup> Guatemala will be the fourth most impacted country by climate change globally, and the worst impacted in LAC.

<sup>15</sup> According to the World Economic Forum's "Global gender gap report" (2009), Guatemala has the greatest gender inequity in Latin America, ranking 111 out of 134 countries worldwide.

<sup>16</sup> See sector notes on indigenous peoples and gender.

<sup>17</sup> There are no statistically significant gender differences in the poverty rates.

<sup>18</sup> All data are for individuals between 25 and 65 years of age. Source: Armendariz, E. et al, "Guatemala y el camino al crecimiento: Una revisión del diagnóstico" [Guatemala and the road to growth: A review of the diagnostic assessment], IDB, 2012.

<sup>19</sup> 40% of the population self-identifies as indigenous.

<sup>20</sup> The Congress of the Republic of Guatemala is comprised of 158 deputies.

<sup>21</sup> Ethnic groups are better represented at the municipal level: 110 town governments are led by indigenous mayors, but only 9 mayors are women.

<sup>22</sup> Human development is understood as the process whereby people are offered greater opportunities for quality of life. The most important of these are a long and healthy life, access to basic health care and education services, and to the resources necessary to enjoy a decent standard of living. Source: UNDP.



## II. THE IDB IN GUATEMALA

- 2.1 The IDB is the country's main source of external finance<sup>23</sup> and one of the key providers of technical assistance.<sup>24</sup> The areas supported by the Bank have been primarily fiscal and municipal (20.0%),<sup>25</sup> social protection (17.7%), financial and capital market development (11.6%), and transportation (10.3%).
- 2.2 During the 2008-2011 strategy period, sovereign guaranteed (SG) loan approvals totaled US\$1.1905 billion.<sup>26</sup> Additionally, eight non-sovereign guaranteed (NSG) operations were approved, for US\$198.2 million (four loans for US\$115.2 million and four Trade Finance Facilitation Program (TFFP) operations for US\$83 million), as well as 17 Multilateral Investment Fund (MIF) operations for US\$9.5 million, and 34 technical cooperation operations for US\$15.2 million.
- 2.3 The main achievements of the Bank's support to the country during this period were the contribution to enhancing the institutionalization of social policy, reduction of extreme poverty in the prioritized municipios, and the enactment of tax reform. In the private sector area, the Bank has contributed to facilitate international trade and improve access to finance for small and medium-sized enterprises, as well as supported mortgage loan access for medium- and low-income families.
- 2.4 The main challenges the Bank has been facing in Guatemala concern the timely execution of investment projects. This issue creates an incentive to find innovative mechanisms to improve performance. Key factors to consider in this area are the limited capacity of the execution units, the high turnover of their staff, budgetary constraints, and the need to ensure the cultural relevance of interventions.<sup>27</sup>

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<sup>23</sup> Over the last four years the Bank has accounted for approximately 38.6% of external public debt and 46.6% of multilateral debt. The World Bank accounts for 25.4% of external public debt and 30.7% of multilateral debt. The CABEI accounts for 18.2% and 22.0%, respectively. Over the last five years the World Bank has increased its share of multilateral debt by approximately 5 percentage points. The IDB has reduced its share by more or less the same proportion. At the close of 2011 the total debt balance of sovereign guaranteed debt with the Bank was US\$2.1612 billion.

<sup>24</sup> "Primer informe nacional para la cooperación internacional para el desarrollo y la eficacia de la ayuda en Guatemala" [First national report for international development cooperation and aid effectiveness in Guatemala], SEGEPLAN, 2011.

<sup>25</sup> Percentage of the amount of sovereign guaranteed loans approved in this area as a share of total sovereign guaranteed loans approved from the Bank's founding to mid-2012.

<sup>26</sup> The sovereign guaranteed loan portfolio is concentrated in the following sectors: education (with 23.5% of the total amount available), environment and natural disasters (19.9%), health (14.0%), water and sanitation (13.3%), energy (9.6%), and trade (9.3%).

<sup>27</sup> Cultural relevance is the degree to which the target beneficiaries value the interventions as relevant to their particular circumstances and needs. Cultural relevance is the suitability of the intervention's outcomes, objectives, and mode of implementation to the sociocultural context in which they occur.

### III. PRIORITY AREAS FOR BANK ACTION

- 3.1 In light of the challenges identified during the analysis phase of strategy preparation, and as the outcome of close collaboration with the Government of Guatemala and the World Bank (WB),<sup>28</sup> this country strategy is structured along two axes: an institutional axis and a rural development axis. The institutional axis will take a traditional, “sector-based approach”<sup>29</sup> with the following priority target areas: (i) fiscal and municipal management; (ii) social protection; and (iii) peaceful coexistence and citizen security. The rural development axis will take a “place-based approach”<sup>30</sup> with the following priority target areas: (iv) productive development; (v) health, and (vi) transportation. In parallel, a crosscutting approach will be taken to the following issues: climate change adaptation and mitigation, natural disaster impact mitigation, indigenous peoples, and gender. Within the priority areas described, the Bank’s private sector windows will support the country through targeted initiatives to stimulate the rural productive sector, develop logistics and transportation infrastructure, develop renewable energy sources, support access to financing for low-income housing and small and medium-sized enterprise, and support for the delivery of basic services.
- 3.2 The priority areas<sup>31</sup> are fully aligned with the “Agenda for Change 2012-2016”<sup>32</sup> Government Plan and are the outcome of prioritization efforts with the new Guatemalan authorities in coordination with the World Bank.

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<sup>28</sup> This country strategy has been produced in close cooperation with the WB. At the government’s request, to maximize the development impact of the two institutions, the WB and the IDB are taking their collaboration beyond specific projects toward a more complete commitment at country level, including the design and monitoring of strategies and portfolio reviews. During execution of this country strategy, cooperation will include teamwork in operational and functional areas and ongoing knowledge transfer. Special attention will be paid to efforts to enhance portfolio execution, including the development of alternative approaches better adapted to the Guatemalan context.

<sup>29</sup> In the sector-based approach, the main unit of analysis is the sector, and development challenges are defined chiefly in relation to it.

<sup>30</sup> In the place-based approach, the main unit of analysis is the territory and its inhabitants. This approach is particularly suited to resolving complex, multidimensional public policy problems, such as rural poverty. See OECD, “The new rural paradigm,” 2006, and Bradford, N., “Place-based public policy,” Canadian Policy Research Network, 2005.

<sup>31</sup> In relation to the lending targets set in the Bank’s Results Framework, adopted at the time of approval of the GCI-9 Report, the country strategy creates opportunities to address the target of poverty reduction and equity enhancement through interventions in social protection, peaceful coexistence and citizen security, productive development, and health. In addition, interventions in peaceful coexistence and citizen security, productive development, and transportation will contribute to the target of regional integration and cooperation. Lastly, the interventions approved during the country strategy period will contribute as a whole to the target of support for small and vulnerable countries (the Group C and D countries).

<sup>32</sup> The “Agenda for Change 2012-2016” Government Plan has five areas of major focus: (i) democratic security and justice; (ii) competitive economic development; (iii) productive and social infrastructure for development; (iv) social inclusion; and (v) sustainable rural development. It is being implemented via three pacts: (i) the Zero Hunger Pact, (ii) the Pact for Peace, Security, and Justice, and (iii) the Fiscal and Competitiveness Pact.

**A. Institutional axis**

- 3.3 This axis will involve efforts from various sectors to improve the effectiveness and efficiency of public policies in Guatemala, and to provide the State with more resources to implement them.

**A.1. Fiscal and municipal management**

- 3.4 Guatemala's public finances face three major challenges: (i) the low tax burden and its vulnerability to external shocks; (ii) substantial budgetary rigidities and the limited execution level of public expenditure; and (iii) the level of municipal debt and the efficiency and effectiveness of public spending at the local level.
- 3.5 Guatemala has the lowest "IDB-CIAT adjusted tax burden"<sup>33</sup> in Latin America (12.3% of GDP in 2010). Since the signing of the Peace Accords,<sup>34</sup> the country has been committed to expanding its tax base and modernizing its income tax (ISR) to make it one of the main pillars of the State's revenue intake. Important progress was made early this year (2012) with the passage of a package of tax reforms, but there is still work to be done. Income tax, and the tax system in general, continue to suffer from structural flaws in design, equity, and efficiency. The tax structure is highly dependent on indirect taxation, particularly the value-added tax (VAT). Moreover, the income tax is characterized by a highly complex tax regime, and collection is severely limited, due in particular to the small tax base, avoidance, and evasion.
- 3.6 There are also serious weaknesses in the execution of public investment expenditure. In the period 2000-2011, the average investment execution rate was 86%. However, the ministries with the biggest budgetary allocations—health, education, and interior—recorded execution levels of around 70%. The reasons for this include substantial budgetary rigidities, institutional segmentation in investment spending policy, and a lack of coordination between the budget and sector needs. Municipal fiscal management also faces major challenges both in terms of controlling public debt and in the quantity, quality, and effectiveness of public investment. Thus, although municipal public debt has been kept below 1% of GDP,<sup>35</sup> it represents around 94% of own revenues. Moreover, certain institutional arrangements, such as the limited influence of the Ministry of Public Finance (MINFIN) in the regulation of municipal debt and finances, and the delegation of the role of credit intermediary to the Instituto de Fomento Municipal [Municipal Development Institute] (INFOM), limit the State's ability to integrate and monitor municipal liabilities. At the same time, the low level of own revenue collection leads to a shortage of resources for municipal investment and a high degree of dependence on central government (whose resources, as we have said,

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<sup>33</sup> Barreix et al., 2012. IDB-CIAT adjusted tax burden = tax revenues + revenue from exploitation of natural resources.

<sup>34</sup> The Peace Accords established the increase of tax revenues as a necessary, but insufficient, condition for peace and development of the country, in order to invest in reducing social disparities and enhancing the inclusion of traditionally vulnerable segments.

<sup>35</sup> Sources: SIAF-Muni and INFOM.

are extremely limited). This is a contributing factor in municipal investment being a mere 0.4% of GDP, which is inadequate to ensure adequate delivery of public services.

- 3.7 In view of these challenges, the Government of Guatemala has proposed a Fiscal Pact for Change, which envisages: (i) implementation of the Law on Payment of Tax Arrears, enacted in early 2012 but pending regulatory development and implementation; (ii) implementation of the Law to Strengthen the Tax System and Combat Fraud and Smuggling, still pending approval; and (iii) implementation of the Transparency and Public Spending Quality Act, now in the process of congressional approval. These legislative initiatives include reforms to the Budget Act, the Act Establishing the Superintendency of Tax Administration, and the promotion of a new Law on Planning and Evaluation of Public Management, among others.
- 3.8 Against this backdrop, the objectives of the Bank's engagement in the sector are to: (a) improve the pattern of taxation; (b) improve budget planning and execution capacity; and (c) strengthen the fiscal capacity of municipalities. To meet these objectives, support will be provided for: (i) regulation and implementation of the Law on Payment of Tax Arrears and the Law to Strengthen the Tax System and Combat Fraud and Smuggling; and (ii) development of the Medium-term Fiscal Policy Framework. In addition, an office will be established within MINFIN to provide assistance with municipal financial administration, a municipal finance monitoring mechanism will be designed and implemented, and municipalities will be supported in including specific climate change adaptation activities in their annual planning exercises, and the Guatemalan government will be supported in designing public policies to improve the use made of available resources, in particular those managed through trusts and other vehicles focused on developing rural productivity.
- 3.9 The risks of the proposed intervention relate to: (i) the need for coordination, cooperation, and signature of agreements between MINFIN and the Superintendency of Tax Administration (SAT) on tax administration policies, which could delay regulatory development of the legislation, and ultimately their implementation; and (ii) failure of the municipalities to adopt the system of fiscal and financial solvency indicators in a timely manner, as a condition precedent to acquiring new debt. To mitigate these risks, the Bank plans to support the country with advisory support and technical assistance programs, and coordinate its activities with the donor community, especially the WB.

## **A.2. Social protection**

- 3.10 Despite the increase in recent years,<sup>36</sup> social protection expenditure in Guatemala is still small and insufficient to meet the country's needs.<sup>37</sup> In addition to the

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<sup>36</sup> From 1.6% to 1.9% of GDP between 2000 and 2010.

<sup>37</sup> During the period 2000-2005 (the most recent comparable data), Guatemala ranked second from last in Latin America, only ahead of Ecuador. During the same period, Guatemala's social spending was less than half the Latin American average. Source: "Guatemala poverty assessment," World Bank, 2009.

limited investment in social areas, Guatemala's social spending is relatively inefficient compared to other LAC countries.<sup>38</sup> Some of this efficiency is due to the sector's complex legislative and institutional framework,<sup>39</sup> and—partly as a consequence of this—the proliferation of programs and projects with low coverage and limited targeting (over 30 identified). Of the programs in the ENCOVI 2011 social assistance module, only the old conditional cash transfer program (MIFAPRO), now renamed *Mi Bono Seguro* (MBS), and the *Bolsas Escolares de Solidaridad* school assistance reached a significant percentage of poor households. In particular, MIFAPRO covered 51.9% of households in extreme poverty (56.3% of the extreme poor in rural areas, and 57.2% of the indigenous extreme poor). On account of their small scale, the remainder of the social assistance programs have little chance of meeting their objective of reducing poverty and vulnerability in any substantial way. Additionally, the existing programs have high levels of leakage. For example, more than 70% of the beneficiaries of *Bolsas de Solidaridad* and *Alimentación Escolar* are not poor, and leakage also exceeds 50% in the *Adulto Mayor* and school scholarship programs. These four programs account for approximately 25% of total social protection expenditure. Moreover, there is evidence that spending on social funds and price subsidies<sup>40</sup> is relatively untargeted.

- 3.11 To address these challenges, the Government of Guatemala has created a Ministry of Social Development. The new ministry is the apex agency for the design, implementation, and evaluation of social development policies, and runs the following programs: (a) the conditional cash transfer program *Mi Bono Seguro* (formerly MIFAPRO); (b) *Mi Bolsa Segura* (formerly *Bolsa Solidaria*); (c) *Comedores Seguros* (formerly *Comedores Solidarios*); and (d) *Jóvenes Protagonistas*.<sup>41</sup> The government's aims with the creation of this ministry include improving program prioritization and coordination, expanding coverage, and reducing leakage. Additionally, the Guatemalan government envisages: (a) establishing a master registry of beneficiaries; (b) recertification of current beneficiaries to reduce leakage to the nonpoor (with the objective of including the

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<sup>38</sup> See sector note and Herrera and Chang, 2004, which projects that, if Guatemala could raise its public efficiency to the LAC average, its education indicators could increase by around 40%, and its health indicators by approximately 11%.

<sup>39</sup> Until 2011, social protection policy was executed by a multitude of ministries and institutions (ministries of education, health, agriculture, infrastructure, communications and housing, labor, the secretariat of the presidency, the first lady's social work secretariat, department of social welfare, social funds, etc.), coordinated by the Council on Social Cohesion with the support of the Department of Planning and Programming, Office of the President. The Food and Nutrition Security Department coordinated the strategic plan for food and nutritional security, as well as programs and projects.

<sup>40</sup> IDB (2007) shows that, in the period 1992-2006, the targeting of resources of both the Fondo de Inversión Social [Social Investment Fund] (FIS) and FONAPAZ failed to benefit the majority of the poorest of the poor. Moreover, Arriagada (2011) notes that "there are a series of inefficient and inequitable subsidies (electricity consumption, mass transportation, fertilizers, etc.) that absorb more than 21% of social assistance spending and benefit mainly the nonpoor population.

<sup>41</sup> For more details of these programs, see "Sector Technical Note: Social Protection" and <http://www.mides.gob.gt/>.

- poorest three deciles of the population) and to match the number of beneficiaries to the available budget (in particular, for *Mi Bono Seguro* (MBS)); (c) the elimination of programs that do not produce results and suffer a high degree of leakage; and (d) strengthening the MBS program's operating procedures.
- 3.12 In this context, the Bank's country strategy objective will be to improve the targeting and target population coverage of social protection programs. To do so, it will support (i) strengthening the institutional framework of the social safety net and fostering a culture of results-based management;<sup>42</sup> (ii) enhancing the effectiveness and operational efficiency of the MBS program; (iii) consolidating the social protection programs and turning MBS into the social safety net platform, (iv) making basic packages of culturally relevant health and education services available—supply development—to meet the demand created by the MBS program; and (v) systematic evaluation of the MBS program's impact.
- 3.13 The risks in this sector are linked to the implementation of a newly created ministry, and the operational and political challenges that entails. The success of the new institutional framework depends mainly on the mechanisms put in place to coordinate the activities of the ministries supplying education and health services, and mechanisms for coordination with local governments. These risks will be mitigated by providing the Government of Guatemala with close, direct support during the reform process, in particular through advisory support and knowledge products. At the same time, the implementation of a strategy of social program rationalization may meet resistance from the institutions affected. To mitigate this risk, the Bank will provide the government with technical assistance on setting clear technical criteria to justify these kinds of decisions.

### **A.3. Peaceful coexistence and citizen security**

- 3.14 Guatemala's murder rate rose substantially in the decade of 2000-2010, climbing from 28.1 per 100,000 inhabitants in 2001, to 41.4.<sup>43</sup> This has led to violence and citizen insecurity being perceived as one of the country's foremost challenges.<sup>44</sup> The factors underlying these levels of violence and insecurity include the lack of financial and human resources to prevent and combat crime, and the fragility of public institutions in this area. The National Civil Police (PNC) has a shortage of 5,610 officers of various ranks, and there is no career structure in the police. Only 4% of the current police force is assigned to criminal investigation work,<sup>45</sup> and only half of these have received specific training. Moreover, the presence of

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<sup>42</sup> One of the Bank's main objectives is to support the industrial organization of the new Ministry of Social Development, and to promote a culture of results-based management using impact and process assessments and results-based budgeting mechanisms.

<sup>43</sup> Guatemala now has the LAC's fourth highest murder rate, although the growing trend reversed in 2011 and the rate dropped to 39 murders per 100,000 inhabitants.

<sup>44</sup> The average number of survey respondents in Latin America who consider violence and citizen insecurity to be the main problem to be addressed is 16.1%; in Guatemala this percentage is twice as high, at 34% (Latinobarómetro, 2011).

<sup>45</sup> This figure is over 10% for other Latin American police forces.

transnational organized crime, the lack of work opportunities and access to quality education, together with gender violence,<sup>46</sup> also heighten insecurity, particularly among the young.<sup>47</sup> In addition to its devastating social impact, the problem of violence and citizen insecurity affects the country's overall development by harming the business climate and generating high public and private costs that undermine competitiveness<sup>48</sup> and entail an additional fiscal burden.

- 3.15 With the Pact for Security, Justice, and Peace, the new government administration aims to develop a cooperative strategy that engages all segments of society and State institutions, based on shared responsibility, to legitimize and make viable a set of high-impact transformations and results that enable better levels of governance, security, and protection from crime, violence, and impunity to be achieved in Guatemala. Specifically, in the case of security, the main lines of action are: (i) implementation of the National Security Policy; (ii) institutional reforms in the PNC and other institutions; (iii) targeted interventions in social prevention and control of criminality; and (iv) development of the national system for citizen participation in security.
- 3.16 As part of this country strategy, the Bank seeks to: (a) strengthen the National Civil Police (PNC) institutionally in such areas as career policing, personnel training, and control of police misconduct; (b) improve the quality and results of criminal investigations;<sup>49</sup> and (c) reduce the vulnerability of women and young people to violence and crime. These objectives are to be pursued by providing technical and financial support to: (i) strengthen the Ministry of the Interior in terms of planning and executing policies against violence; (ii) support the PNC institutionally to create a career policing structure and improve the technical skills of its personnel; (iii) implement a social prevention plan, targeting interventions to the areas and populations at greatest risk of violence, in order to reduce their victimization; and (iv) strengthen coordination among the institutions providing

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<sup>46</sup> "Gender violence" is defined as violence directed against women because they are women. This type of violence takes many forms, including partner homicide and violence; sexual abuse and rape; trafficking of women and girls; forced prostitution; violence during armed conflict; forced pregnancy; honor killings; dowry abuse; female infanticide and prenatal sex selection of the fetus in favor of baby boys; female genital mutilation, and other harmful traditional practices.

<sup>47</sup> Approximately 60% of homicide victims in Guatemala are young people between 20 and 39 years of age. Moreover, the exposure of vulnerable youths to socioeconomic, interpersonal, and community risk factors may lead to their involvement in criminal activities. The risks factors identified include: (i) lack of opportunities for social, cultural, or economic mobility; (ii) impunity; (iii) school dropout; (iv) low pay for unskilled workers; (v) lack of parental guidance, supervision, and support; (vi) ill-treatment in the home; and (vii) acquaintances who are gang members (WHO, 2003).

<sup>48</sup> According to the World Economic Forum, 28% in Guatemala consider crime and robbery to be the main factor detrimental to the business climate (Global Competitiveness Report 2011-2012). In absolute terms, Guatemala devotes a larger budget to security and justice compared to other countries in the region, yet it remains below the regional average in relative terms, measured as a percentage of GDP (ECLAC data). The costs originating from crime and violence in Guatemala represent 7.7% of GDP (World Bank, "Crime and violence in Central America," 2011).

<sup>49</sup> Investigations conducted in a timely manner, based on internationally recognized and applied investigation procedures, with a higher percentage of cases solved, etc.

security to the population. In this area, the Bank is exploring a comprehensive neighborhood improvement strategy with the Guatemalan government, focused on enhancing citizen security (i.e., the *Barrio Seguro* program), which will be developed jointly with the World Bank. Interventions through the MIF window are also envisaged in this sector.<sup>50</sup>

- 3.17 The main sector risk is linked to the country's institutional capacity to implement the institutional enhancements effectively and in a coordinated way. To mitigate this risk, emphasis will be put on disseminating information that shows what effect the proposed policies can have, and strengthening the monitoring and evaluation of sector interventions. Also, given the institutional fragmentation among security and justice bodies, strategic partnerships will be sought to promote reforms involving the various actors. This also includes strengthening mechanisms for citizen oversight in internal affairs bodies, and community organizations promoting neighborhood development in ways compatible with culturally relevant social protection policies and instruments. At the same time, the complexity of the issue (i.e., the need for a multisector and multiregion approach, challenges of working with illegal activities, etc.) and the limited empirical evidence available represent an additional challenge. This risk will be mitigated through support for interventions with multisector technical assistance from the Bank, and collaboration with the network of outside specialists for additional support when specific expertise is required.

## **B. Rural development axis**

- 3.18 Over half of Guatemala's population (51.5%) lives in rural areas, 71.3% of them in poverty, and 21.1% in extreme poverty. The situation is particularly serious in rural areas of the North (where extreme poverty is as high as 43.2%, and total poverty 86.6%), Northeast, Southwest, and Petén regions. These high rates are explained by the low levels of household incomes, limitations on access to basic social services, and the insufficient infrastructure quality and coverage.
- 3.19 The persistence of extreme poverty in rural areas has led to a new conceptual framework to address the problem, based on a place-based, multiproductive, and multisector approach. Consistent with this framework,<sup>51</sup> in order to promote rural development, the Bank will implement this axis through the areas of productive development, health, and transportation,<sup>52</sup> in coordination with the portfolio of projects now under way. The Bank will identify the interventions in the rural development area and determine a coordinated roadmap for the array of actions to

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<sup>50</sup> Principally in relation to programs for job placement in productive activities or training for at-risk youth.

<sup>51</sup> This approach is consistent with the one promoted by the Global Donors Platform for Rural Development (GDPRD). The GDPRD is a network of 34 bilateral and multilateral development cooperation organizations, international financial institutions, intergovernmental organizations, and development agencies (including the IDB, the World Bank, IFAD, FAO, WFP, the OECD, the European Commission, UNODC, and USAID), whose aim is to reduce poverty in developing countries and foster the sustainable growth in rural areas.

<sup>52</sup> These areas have been identified as crucial to overcoming the persistence of nonurban poverty.



overcome the challenges identified, bearing in mind the synergies and potential economies of conglomeration (inter- and intraterritorial).

- 3.20 This approach is consistent and aligned with the “Agenda for Change 2012-2016” Government Plan. Specifically, the Guatemalan government has presented an updated rural development strategy, the “Plan to advance and adapt the national integrated rural development policy,” which promotes a policy with a coordinated, multisector, place-based approach to improve living conditions for the rural population. Sustainable, integrated rural development is, in fact, one of the five priority areas of the “Agenda for Change 2012-2016.”<sup>53</sup>
- 3.21 On the rural development axis, the Guatemalan government seeks to promote actions in productive development, health, and rural transportation. In productive development, the government aims to facilitate access to productive activities for rural dwellers, promote formal employment in rural areas, and stimulate the creation of micro, small, and medium-sized enterprises (MSMEs). In health, the focus will be on care for pregnant women, childbirth and the postpartum care, and care for newborns. An additional aim is to create the conditions for adequate growth during childhood, with a comprehensive health package targeted to children through the *Hambre Cero* [Zero Hunger] program.<sup>54</sup> In transportation, areas of rural poverty and extreme poverty will be addressed by facilitating investments to improve the population’s access to basic health care services and to promote job creation. This will be done without neglecting the main routes and logistic transportation corridors contributing to the country’s economic development.

### **B.1. Productive development<sup>55</sup>**

- 3.22 The rural economy is at present highly dependent on farming, which employs 66.8% of the rural population, 77.0% of whom live in poverty. Small and medium-scale farmers working 32 *manzanas*<sup>56</sup> of land or less constitute the majority of mixed farming operations (over 80%); 73% of farmers work less than 5 *manzanas* of land. Subsistence farming predominates,<sup>57</sup> and the most disadvantaged rural communities are isolated from the export agriculture sector. The rural population’s lack of access to the basic factors of production (mainly

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<sup>53</sup> See footnote 33.

<sup>54</sup> Integrated Management of Childhood Illness (IMCI) is a strategy developed by the World Health Organization (WHO) and the United Nations Children’s Fund (UNICEF), launched in 1996 as the principal strategy to improve child health. It focuses the care of children under 5 more on their overall health than on the diseases affecting them at a given time.

<sup>55</sup> In the context of this country strategy, productive development is defined as the set of actions intended to promote the creation, spread, consolidation, and/or growth of the business fabric.

<sup>56</sup> A *manzana* of land is equal to 0.7 hectares.

<sup>57</sup> Infra-subsistence households are those farming a plot of less than 0.5 *manzana*; subsistence households farm a plot of between 0.5 and 1 *manzana*.

human capital,<sup>58</sup> natural resources, and technology) is a key determinant of rural poverty,<sup>59</sup> affecting both agricultural and, especially, nonagricultural productive development, where gains have proven crucial to the socioeconomic development of the most disadvantaged regions.<sup>60</sup> This lack of access is particularly pronounced among women and the indigenous population.<sup>61</sup> It is therefore necessary to promote policies to overcome these shortcomings, enable productivity gains and business development, and diversify sources of rural income (i.e., increasing the share from nonfarming sources, stimulating diversification of production, fostering rural/urban linkages, etc.)

- 3.23 The main objectives of the country strategy in this area will be to: (a) increase rural income per capita, particularly of households in poverty and extreme poverty; and (b) diversify sources of income of rural households. This will be done through actions to: (i) identify productive clusters and product spaces<sup>62</sup> and work to strengthen them; (ii) identify economies of conglomeration and scale in and among the regions identified; (iii) promote business, particularly where it involves job creation and higher incomes for the poorest of the poor (considering also the special needs of indigenous peoples and households headed by women), through training or demand generation programs, and (iv) support the development and implementation of actions to improve access to, and dissemination of, production technologies. These actions will try to identify and leverage potential regional synergies, in particular those with bordering countries. Some of these actions will be pursued through the Bank's private sector (non-sovereign guaranteed) windows. Specifically, support will be provided for the agribusiness sector, manufacturing, tourism, access to quality products and services accessible to the base of the pyramid, and other sectors employing disadvantaged populations.

## **B.2. Health**

- 3.24 In addition, related to the above is the pressing need to improve the rural population's overall health, since current conditions restrict human development and productive potential. 58.6% of children under 5 in rural areas suffer from

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<sup>58</sup> See Section B.2, "Health." In addition, 90% of senior secondary schools are located in urban areas. (The figure is 60% for the primary schools, even though a much higher proportion of the school-age population lives in rural areas.)

<sup>59</sup> IDB, "Priorities and strategies in rural poverty reduction," 2004.

<sup>60</sup> The evidence shows that the inclusion of effective policies to stimulate a rise in rural nonfarm income and rural nonfarm employment in rural poverty reduction strategies are decisive factors in their success.

<sup>61</sup> In Guatemala, households headed by men have an average income of US\$71, whereas in those headed by women the figure is US\$43. 70% of male-headed households have land, compared with 40% of those headed by women. Women who do have land have smaller plots. On average, women's plots are 30% of the size of men's (ECLAC, 2011). The average wages earned by the indigenous rural working population is 62.1% of the average for the nonindigenous rural working population (ENEI, 2011).

<sup>62</sup> Product space: network of products requiring similar inputs for their production and commercialization. See C. A. Hidalgo, B. Klinger, A.-L. Barabási, R. Hausmann, *Science* 317 (2007).

chronic undernourishment<sup>63</sup> (compared with 34.3% in rural areas), and the mortality rate of children under 59 months (per 1,000 live births) is 50% higher in rural areas. The problems of undernourishment among children are compounded by a growing prevalence of obesity and anemia, particularly among women of childbearing age.<sup>64</sup> The country is therefore facing a “double nutritional burden,” due primarily to a combination of poor diet quality and poor eating habits. There is also a serious shortage of qualified health care personnel, a fact reflected in the high maternal mortality rate, among other things.<sup>65</sup> The majority of maternal deaths are the result of complications during childbirth within the first 24 hours after delivery. The percentage of institutional births in rural areas is 36.4%, compared with 76.7% in urban areas. Many rural women have only one prenatal checkup (54.3%), and only a few have two or three prenatal checkups (21.9% and 5%, respectively). Half of all physicians and a third of technical staff are located in the Metropolitan Region (covering just 20% of the population),<sup>66</sup> and the physical infrastructure for primary, secondary, and tertiary care is deficient.<sup>67</sup> These shortcomings are a reflection of a centralized model of care that has significant repercussions throughout the life cycle.

- 3.25 The main objectives of the country strategy will therefore be to: (a) reduce under-5 chronic undernourishment in rural areas; (b) reduce child mortality in rural areas; and (c) improve maternal health in rural areas. This will be done through support for the design and implementation of preventive health care programs focused on (i) the 1,000 day window, (ii) promotion of programs to improve diet quality through awareness campaigns, etc.; and (iii) the design and expanded coverage of a comprehensive primary health care package.

### **B.3. Transportation**

- 3.26 Related to the issues discussed in the “Productive development” and “Health” sections, the extent and quality of road transportation has also been identified as a bottleneck for the country’s economic and social development. Guatemala’s rural area covers 104,375.8 square km, and the country has 4,100 km of rural roads.

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<sup>63</sup> The prevalence of chronic undernourishment among indigenous children is even higher, affecting 65.9% of children under 5. In some rural departments, such as Totonicapán, the chronic undernourishment rate among children aged 3 to 59 months is over 80%.

<sup>64</sup> Half of Guatemalan women between 15 and 49 years of age are overweight or obese. Maternal overweight and obesity expose the fetus to an altered metabolism with high levels of glucose, increase the risk of gestational diabetes, and induce greater deposition of adipose tissue. If the mother is also short of stature, the newborn is overweight but lags behind in linear growth. The ENSMI 2008-2009 data indicate that the prevalence of anemia is 21.4% among nonpregnant women, and 29.1% among pregnant women. The consequences of maternal anemia include the newborn’s having low iron reserves, higher newborn and maternal morbidity and mortality rates, increased risk of premature birth, and low birth weight, among other effects.

<sup>65</sup> Maternal mortality (153/100,000 live births in 2006) is three times higher among the indigenous population (211/100,000 live births) than the Ladino population (70/100,000).

<sup>66</sup> There are just two physicians per 10,000 inhabitants in rural areas.

<sup>67</sup> Investments in the service network has been limited and has not kept pace with population growth. This has led to serious shortfalls at all levels of care.

Just 44% of the country's roads are paved. The density of paved highways is 6.30 km/100,000 square km, and 25 chief towns of municipios still have no paved access. Given Guatemala's mountainous terrain and the incidence of natural disasters, these shortcomings translate into the isolation of a large share of the rural population, not only in terms of engagement in productive activities (i.e., income generation, access to raw materials, connectivity to markets, lower logistics costs, etc.), but in terms of access to goods (i.e., food) and basic services (i.e., health) or to knowledge and technology transfer.<sup>68</sup> This lack of access therefore contributes to perpetuating poverty and inequity.

- 3.27 The main objectives in this area will therefore be to: (a) expand the rural road system; and (b) improve the infrastructure quality of the existing road system, all with a view to facilitating productive development and access to health services, among other things. The actions to achieve these objectives will include: (i) road system maintenance; (ii) technical assistance to promote regulatory frameworks for the development of public-private partnerships to build infrastructure; and (iii) technical and financial support to encourage road system expansion. These actions will pay special attention to the threat of climate change and natural disasters, and will be aligned with the relevant regional projects. Additionally, in relation to the objectives identified, the dialogue with the government on logistics issues will be deepened, in particular as regards promoting regional logistics corridors. This is also expected impact productive development and the development of the mid-sized cities, which are a significant source of job creation for the rural population, and whose development is crucial to the country's socioeconomic progress.
- 3.28 The main risks facing the promotion of rural development overall are those implicit in the coordination of multiple agents, i.e., central government, subnational governments, and private agencies and institutions, as well as the various sectors of the Bank. To attenuate these risks, the Bank plans to maintain ongoing dialogue with the various agents, strengthen multisector coordination—inside and outside the Bank—and support interventions with technical assistance. In addition, it will coordinate closely with other multilaterals and key institutions in the field, in order to ensure that interventions are comprehensive in nature. Another added risk is Guatemala's low tax burden and the limited execution capacity of the institutions involved in these areas (i.e., productive development, health, and transportation). The Bank will therefore continue its support to strengthen public finances, as well as continue to foster institution-strengthening in general with technical assistance and training programs.

### **C. Crosscutting areas**

- 3.29 This set of interventions will take regional integration into account, particularly in productive development, health, transportation, and peaceful coexistence and citizen security. Program design in the social protection areas and rural development axis will take indigenous populations, their cultural realities, and

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<sup>68</sup> Ellis, S. D., "Key issues in rural transport in developing countries," 1997.

other differentiating features especially into account, and will include the gender perspective. Specifically, in the health area, efforts will be made to promote culturally relevant actions, and the priority target population will be poor indigenous women with low educational attainment in rural areas and their children. Moreover, in the productive development area, mechanisms will be sought to promote the integration of women and indigenous people into the formal labor market, and support their efforts to start businesses, as well as the diversification of their economic activities. Climate change mitigation and adaptation will also be a focus in this area. In the transportation area, especially the development and strengthening of road infrastructure, emphasis will be given to environmental sustainability, climate change adaptation, and natural disaster risk mitigation. The gender perspective will also be emphasized in the peaceful coexistence and citizen security area.

#### **IV. LENDING FRAMEWORK**

- 4.1 The Bank is considering two scenarios for sovereign guaranteed lending. These have been designed on the basis of fiscal financing needs, the public debt management strategy, and the Guatemalan government's economic growth assumptions. Both lending scenarios are tentative and subject to the availability of Bank resources and annual programming exercises. The base scenario envisages total loan approvals of US\$740 million for the country strategy period. This scenario projects a positive net flow of capital for the country (US\$365.8 million) and entails a slight reduction in the IDB's share of the country's external public debt (from 33.7% to 33.2%) during the country strategy period, with the IDB's share of multilateral debt remaining unchanged (i.e., around 46.0%). The high scenario (US\$900 million) would be presented in a context of external shocks such as a deterioration of the international economic environment or climate factors. It is assumed that this situation would lead to an increase in the fiscal deficit of half a percentage point of GDP in 2014 (trigger indicator for the high scenario).<sup>69</sup> In the high scenario, the Bank increases its exposure to the country, increasing its share of external debt from 33.7% to 34.2%, and its share of multilateral debt from 46.1% to 46.5%. Both scenarios project a reconfiguring of external debt in which sovereign bonds make up a larger share of the total, and both are consistent with the country's fiscal sustainability.

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<sup>69</sup> If the potential trigger were a natural disaster, the economic impact would need to be valued at an amount equivalent to at least half a percentage point of GDP for this to take effect.

# SOVEREIGN DEBT LENDING SCENARIO 2012-2016

(US\$ Millions)

	BASE					HIGH					BASE	HIGH
	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016	TOTAL*	TOTAL*
Approvals	237.2	323.1	94.6	85.1	-	237.2	375.0	202.7	85.1	-	740.0	900.0
Disbursements	140.0	317.2	357.8	93.2	87.0	140.0	317.2	401.8	237.2	87.0	995.3	1,183.3
Repayments	100.4	106.4	124.2	138.9	139.8	100.4	106.4	124.2	138.9	139.8	609.8	609.8
Net loan flow	39.6	210.8	233.6	(45.7)	(52.8)	39.6	210.8	277.6	98.3	(52.8)	385.5	573.5
Subscriptions	4.1	3.9	3.9	3.9	3.9	4.1	3.9	3.9	3.9	3.9	19.7	19.7
Net capital flow	35.5	206.9	229.7	(49.6)	(56.7)	35.5	206.9	273.7	94.4	(56.7)	365.8	553.8
Interest and fees	83.7	83.0	83.4	81.3	82.9	83.7	83.0	84.9	87.9	89.5	414.4	429.1
Net cash flow	(48.2)	123.9	146.3	(130.9)	(139.6)	(48.2)	123.9	188.8	6.5	(146.2)	(48.6)	124.7
<b>IDB Debt</b>	<b>2,153.4</b>	<b>2,364.1</b>	<b>2,597.8</b>	<b>2,552.1</b>	<b>2,499.3</b>	<b>2,153.4</b>	<b>2,364.1</b>	<b>2,641.8</b>	<b>2,740.1</b>	<b>2,687.3</b>	<b>12,166.6</b>	<b>12,586.6</b>
IDB debt/GDP (%)	4.3	4.4	4.6	4.2	3.9	4.3	4.4	4.6	4.5	4.2	4.3	4.4
IDB debt/Public debt (%)	17.2	17.5	17.9	16.5	15.2	17.2	17.5	17.8	17.2	15.7	16.9	17.1
IDB debt/External debt (%)	33.7	34.2	36.3	34.8	33.2	33.7	34.2	36.0	36.2	34.2	34.5	34.9
IDB debt/Multilateral debt (%)	46.1	46.7	48.0	46.6	46.0	46.1	46.7	47.1	48.0	46.5	46.7	46.9

Source: Ministry of Public Finance, Guatemala, IDB, International Monetary Fund, World Bank forecasts.

\* Average in the case of debt ratios

- 4.2 In both scenarios, the aim will be to frontload approvals in the first years of the strategy so as to facilitate the startup of project execution during the corresponding country strategy period.

## V. STRATEGY IMPLEMENTATION

- 5.1 **General considerations.** To achieve the proposed objectives, the country strategy calls for the following:

- Meet the country's needs through a combination of instruments and projects of an appropriate scale. Efforts will be made to ensure that interventions reflect lessons learned regarding cultural relevance and fostering noncentralized execution systems that involve local communities throughout the project cycle. Crosscutting ethnic and gender equity promotion can be implemented, where relevant, by targeting specific groups (i.e., indigenous peoples and women) and including specific activities and/or components within operations.
- Strengthen program design, execution, and monitoring. In the 2012-2016 country strategy, the Bank and the Ministry of Public Finance (MINFIN) will analyze<sup>70</sup> new execution routes that enhance the value-added of interventions. The planned actions include: (a) strengthening of the Bank's portfolio support and technical assistance role;<sup>71</sup> (b) innovation in contracting and execution through resource administration agencies and trustees; and (c) reformulation

<sup>70</sup> This analysis will be conducted jointly with the World Bank, which faces the same execution challenges.

<sup>71</sup> For example, through external expertise engaged on an ad hoc basis, if advisory support is required in some specific area (i.e., building infrastructure in the social sector), or the strengthening of portfolio monitoring and supervision.

of the portfolio in areas where the need is identified.<sup>72</sup> It will also be essential to: (i) work on improving operation design (i.e. scale, mode of execution and identification of suitable execution units, strengthened multisector collaboration); (ii) synchronize the Bank's interventions with the national planning and budgetary cycle;<sup>73</sup> (iii) work with the government to strengthen the execution units' technical capacity (i.e., development of comprehensive training programs, Bank involvement in selection processes or in defining terms of reference), reduce staff turnover, and design effective incentives for operations to progress; (iv) work with execution units and MINFIN on project execution plans (PEPs), aligning budget allocations with the PEPs (or vice versa); (v) support loan operations with more technical assistance; and (vi) coordinate actions with the Government of Guatemala to work more closely with the Congress of the Republic in the process of program approval.<sup>74</sup> The MIF's capacity to test new approaches by means of pilot projects will also be utilized.

- c. Lastly, building on progress made in execution, sector dialogue with the Government of Guatemala will be deepened in the areas of education and energy. Thus, if project implementation in these areas advances significantly, additional support could be considered to contribute to the country strategy objectives.

**5.2 Country systems.** The management and supervision of Bank operations currently relies on the following country systems: budget, cash management,<sup>75</sup> and procurement information system. In the area of financial administration, the country's efforts to enhance its budget and cash management subsystems will be supported during the strategy period, focusing on the development and institutionalization of the SIAF as a management tool,<sup>76</sup> with the objective of raising the operational efficiency of the country's financial management and, therefore, of Bank-financed operations. The government will also be supported in the process of validating the accounting and reports subsystems, in order to determine its capacity to manage operations, such that their gradual utilization contributes to the integrated and effective management of Bank-financed operations in Guatemala. In the area of procurement, the government will be

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<sup>72</sup> The criteria for reformulation of operations will include: (i) the relevance of the interventions to achieving the country strategy objectives and outcomes; (ii) the complexity of the execution model; and (iii) the institutional and technical capacity of the execution units.

<sup>73</sup> Design and execution of operations linked and matched to the dynamics of the National Public Investment System (SNIP) and the Integrated Financial Administration System (SIAF).

<sup>74</sup> The Bank intends to work together with the Guatemalan government and other political stakeholders from the earliest phases of the projects. During this process, the projects' relevance and contribution to the country's development will be stressed from the design stage, seeking to build consensus through technical criteria.

<sup>75</sup> The budgeting, cash management, accounting, and reports systems together comprise Guatemala's Integrated Financial Administration System (SIAF).

<sup>76</sup> SIAF development to bring it into line with international standards on accounting, internal control, expenditure classification, and technology platform.

supported in implementing its Public Procurement Strategic Plan, which was the outcome of the diagnostic assessments. The plan emphasizes institution-strengthening and the development of a transactional purchasing system that covers the entire procurement cycle, from planning to full contract completion. In this context, support will be given on the preparation of standard bidding documents for goods and works, harmonized with those of the Bank.<sup>77</sup> The table below summarizes the status of Guatemala's country systems and the anticipated developments during the country strategy period.<sup>78</sup>

Use of country systems <sup>79</sup>	Baseline 2012	Projected use 2016	Planned actions
<b>Financial management</b>			
Budget	100%	100%	Development and institutionalization of SIAF.
Cash management	100%	100%	
Accounting and reports	0%	100%	Evaluation and acceptance of SIAF for the management of Bank-financed operations.
Internal audits	0%	0%	N/A
External audits	0%	0%	N/A
<b>Procurement</b>			
Information system	100%	100%	Support for development of public procurement transactional system.
Shopping	0%	20%	Strengthening of institutional structure under the current strategic plan.
Individual consultants	0%	0%	N/A
Partial NCB	0%	0%	Development of standard bidding documents for goods and works, and strengthening of institutional structure under the current strategic plan.
Advanced NCB	0%	0%	N/A

**5.3 Coordination with other donors.** The country strategy has been designed and developed in close collaboration with the World Bank. The two agencies held a dialogue meeting with the government, where they presented diagnostic assessments of the country's challenges and recommendations to meet these challenges jointly in several areas. The dialogue has been ongoing since this first meeting, and collaboration efforts have taken shape in the country strategies to be approved by the two institutions this year. Closer coordination or partnership are envisaged in the areas of fiscal and municipal management, social protection, peaceful coexistence and citizen security, productive development, health, and transportation. There will also be a close collaboration on regional development of logistical transportation corridors.

**5.4** It has also been agreed with the WB that a working team will be established to analyze the execution challenges faced by both institutions in implementing their

<sup>77</sup> The Bank's standards are aligned with international good practices in procurement.

<sup>78</sup> For details, see electronic link, "Sector Technical Note: Fiduciary."

<sup>79</sup> Use: Percentage of the Bank's active loan portfolio (operations) managed using country systems.



programs. Although cooperation in this area has begun, it is expected to be formalized with the official appointment of a team and setting of a timetable, identifying the priority objectives and drawing up a work plan. This coordinated strategy is expected to be the first step towards even closer partnership between the two institutions.

- 5.5 On a more general level, the Bank is taking part in the technical coordination forums created by the government jointly with the “G-13 Donors Group,” as well as meetings of the Dialogue Group, a high-level G-13 body that aims to ensure effective coordination with other cooperation agencies.
- 5.6 The main areas where the Bank envisages working jointly or complementarily with other cooperation agencies are: (i) rural development, with the WB, USAID, CABEI, FAO, IFAD, and AECID; (ii) social protection, with the WB; (iii) peaceful coexistence and citizen security, with the WB, EU, and USAID; (iv) fiscal and municipal management, with the WB, IMF, and EU; and (v) gender, with UNIFEM and AECID. Overall, coordination and collaboration with the community of bilateral and multilateral actors operating in the country is expected to continue, and in particular with the WB in the areas described above.

## VI. RISKS

- 6.1 **Macroeconomic risks.**<sup>80</sup> Guatemala is highly vulnerable to external shocks. The country is exposed to the uncertainty of the global environment, the volatility of international commodity prices, and climate factors. A deep recession in the United States—the country’s main trading partner and source of remittances—would have adverse effects on the economy. A significant rise in food and oil prices would lead to inflationary pressures, with an impact on poverty. A large-scale natural disaster would put pressure on public spending to meet emergency and reconstruction needs, which would have fiscal repercussions. In turn, the low level of tax revenue intake leaves little room for maneuver to address contingencies, which could limit the strategy’s impact. As mitigation measures, the Bank will work to make financial and technical advisory support instruments available to mitigate the adverse impacts of such events.
- 6.2 **Implementation risks.** The challenges of implementing investment programs, identified in Section V of this country strategy could jeopardize its scope. To mitigate these risks, the actions included in the paragraph 5.1 are envisaged, in terms of stepping up efforts to accelerate program execution, as well as explore new ways of working with the Congress of the Republic of Guatemala when it considers Bank projects.

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<sup>80</sup> Under the mandate as part of the agreement of the “Report on the Ninth Increase in the Resources of the Inter-American Development Bank,” sustainability analyses of borrowing member countries are being conducted annually.

## MAIN ECONOMIC AND SOCIAL INDICATORS

Guatemala: Main macroeconomic indicators						
	2008	2009	2010	2011	2012p	2013p
<b>Real sector</b>						
Nominal GDP (US\$ millions)	39,145	37,672	41,178	46,910	50,303	53,564
GDP per capita (US\$)	2,861	2,690	2,867	3,154	3,287	3,469.52
GDP (real % change)	3.3	0.5	2.8	3.9	3.1	3.2
Consumption (real % change)	5.0	1.1	4.5	4.1	2.1	3.5
<b>Fiscal Sector</b>						
Total central government revenues (% GDP)	2.0	11.1	11.3	11.8	11.8	11.6
<i>Central government tax revenues (% GDP)</i>	11.3	10.3	10.5	11.0	10.9	10.9
Total central government expenditure (% GDP)	13.6	14.2	14.6	14.7	14.3	14.0
Central government primary balance (% GDP)	-0.3	-1.7	-1.8	-1.3	-1.1	-0.6
Interest (% GDP)	1.4	1.4	1.5	1.5	1.5	1.8
Central government fiscal balance (% GDP)	-1.6	-3.1	-3.3	-2.8	-2.4	-2.4
<b>Public debt</b>						
Total public debt (% GDP)	20.0	22.9	24.1	24.1	24.8	25.2
External public debt (% GDP)	11.2	13.0	13.1	11.7	12.6	12.9
Domestic public debt (% GDP)	8.9	9.9	11.0	12.3	12.2	12.3
<b>Balance of payments</b>						
Current account (% GDP)	-4.3	0.0	-1.5	-3.6	-3.7	-3.4
Current account (US\$ millions)	-1,680	7,5	-626	-1,668	-1,635	-1,824
<i>Exports – FOB value (US\$ millions)</i>	7,847	7,295	8,536	10,607	11,873	11,400
<i>Imports – FOB value (US\$ millions)</i>	13,421	10,643	2,807	15,717	17,285	18,700
Financial account (% GDP)	3.7	0.5	3.8	4.4	4.4	n/a
<i>Foreign direct investment (US\$ millions)</i>	754	600	806	911	1,003	n/a
International reserves (US\$ millions)	4,659	5,213	5,954	6,188	6,300	6,400
<i>International reserves (months of imports)</i>	3.8	5.4	5.2	4.5	4.5	4.3
<b>Exchange rate, prices, and interest rates</b>						
Exchange rate (Q/US\$, end of period)	7.8	8.4	8.0	7.8	8.1	8.4
Inflation CPI (% end of period)	9.4	-0.3	5.4	6.2	4.3	5.4
Benchmark rate (end of period)	7.25	4.5	4.5	5.5	5.3	5.6
<b>Social indicators</b>						
Population (millions)	14.7 (2011)	Human Development Index ranking			131/187 (2011)	
Percentage indigenous population	39.6 (2002)	Child chronic undernourishment (%)			49.8 (2008/09)	
Total poverty (%)	53.7 (2011)	Child mortality rate (per 1,000 births)			24.8 (2010)	
Gini coefficient	0.585 (2006)	Average years of schooling			4.1 (2011)	
Sources: BANGUAT, INE, UNDP, ECLAC and World Bank. p/ Projections 2012-2013 from MINFIN, IMF (WEO), and Consensus Forecast.						

## MACROECONOMIC CONTEXT

Guatemala has gradually recovered since the international financial crisis. GDP growth averaged 2.7% in 2008-11. After the sharp economic slowdown in 2009, and the disasters that affected economic performance in 2010—the eruption of the Pacaya volcano and tropical storm Agatha—economic growth picked up speed in 2011 (3.9%). This acceleration was mainly driven by an increase in external demand and an upturn in private consumption. The global risks remain high, however. Therefore, Guatemala's prospects for economic growth are moderate. GDP is projected to grow at between 2.9% and 3.3% in 2012.<sup>81</sup> GDP growth is forecast to reach levels close to 3%<sup>82</sup> in the coming years, falling short of its potential.

Economic growth is being driven by private consumption. Final consumption by households and nonprofit institutions in Guatemala accounts for approximately 85% of GDP, a share which has changed little in recent years. Although private consumption dropped in 2009, its growth has rebounded to precrisis levels (close to 4% in 2010-2011). Private investment has fallen sharply in the last few years: relative to GDP, it fell from 17% in 2006 to 14.8% in 2008. In the face of the international financial crisis, the drop in investment was accentuated in 2009, reaching its lowest level of the decade (11.2% of GDP). Since then, private investment has slowly recovered, but it is still a long way below its precrisis level (12.5% of GDP in 2011).

In order to mitigate the effects of the 2009 international financial crisis, and in particular to soften the economic slowdown, the government implemented a countercyclical fiscal policy centered on expanding current expenditure. This fact, in conjunction with the drop in tax revenues, led to a significant increase in the fiscal deficit, which doubled between 2008 and 2009, rising from 1.6% to 3.1% of GDP. It rose again slightly in 2010. Despite 2011's being an election year, a gradual fiscal adjustment process was begun, achieving a reduction in the deficit of ½ percentage point of GDP (2.8% of GDP). This trend is expected to continue in 2012, with the deficit standing at around 2.4% of GDP at the end of the year. The medium-term fiscal target stands at 1.9% of GDP. In parallel, as a result of the foregoing, government debt increased by 4 percentage points of GDP between 2008 and 2010 (from 20% to 24.1% of GDP). In 2011, government debt remained unchanged from the previous year (24.1% of GDP). Nevertheless, a change in the composition was observed, as the share of domestic debt in central government debt increased from 45.9% in 2010 to 51.3% in 2011, exceeding the contribution of external debt (48.7%). For 2012 it is estimated that government debt will stand at 24.8% of GDP. The analysis of fiscal sustainability shows that the levels of public debt are sustainable in the near term, provided that fiscal policy remains prudent.

Thus, it is expected that the package of tax reforms approved in early 2012 will contribute to the process of fiscal consolidation. Implementing the tax reforms will bring in estimated

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<sup>81</sup> Banco Central de Guatemala (BANGUAT), 2012.

<sup>82</sup> Consensus Forecast (2012).

extra revenues of around 1% to 1.5% of GDP from 2013 onward.<sup>83</sup> This would help convergence towards the primary surplus required for medium-term debt sustainability. At the same time, the initiatives in the Transparency and Public Spending Quality Act, currently in the process of obtaining congressional approval, will help improve efficiency, transparency, and accountability.

Prices are expected to remain stable. However, possible external shocks—particularly an increase in international food and oil prices—would produce inflationary pressures. At the end of 2011 the inflation rate reached 6.2%, which is close to the upper limit of the target range (5% +/- 1 percentage point). Inflation is likely to be around 5.3% at the end of 2012,<sup>84</sup> which is within the target range (4.5% +/- 1 percentage point).

The current account deficit is manageable and is financed from relatively stable currency flows. The current account registered a deficit of 3.6% of GDP in 2011, which represented a significant increase with respect to 2010 (1.5% of GDP). Foreign direct investment inflows financed half of the external deficit. A current account deficit similar to that of the previous year (3.7% of GDP)<sup>85</sup> is expected for 2012. Guatemala's international liquidity indicators are adequate to face any suddenly arising financial needs. The ratio of international reserves to short-term external debt was 115% in 2011. Consequently, Guatemala's reserves are sufficient to confront the first round of the effects of a potential financial market closure making it unable to refinance its debt on maturity.

The financial indicators and results of the risk analysis suggest that the banking system is sound. Total private sector credit came to 25.7% of GDP in 2011, which reflects an increment of almost one percentage point of GDP on 2010. Increased inflows of "other" private capital flows—external lending to the banks—and the sharp expansion of credit in dollars imply certain financial risks. Nevertheless, the regulatory framework envisages exchange rate risk control mechanisms.

Certain risks exist linked to the uncertainties of the global environment, the volatility of international commodity prices, and climatic factors. A deep recession in the United States—the country's main trading partner and source of remittances—would have adverse effects, particularly on exports and remittances, and therefore on economic growth and tax revenues. A significant increase in food and petrol prices would lead to higher than expected inflationary pressures. A large-scale natural disaster would put pressure on public spending, given the need to tackle the emergency and undertake subsequent reconstruction, which would lead to postponement of the process of fiscal consolidation. Finally, the country has little room for maneuver to adopt countercyclical policies, and consequently, limited opportunities for making active use of fiscal and/or monetary policy to mitigate the negative effects of a potential deterioration in the global environment.

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<sup>83</sup> Provided that macroeconomic conditions remain in the base range that MINFIN has used for projections.

<sup>84</sup> Banco Central de Guatemala (BANGUAT), 2012.

<sup>85</sup> Ibid.

## LENDING FRAMEWORK

Guatemala is the process of fiscal consolidation. The deterioration in its fiscal situation in the wake of the 2009 international financial crisis, and the natural disasters hitting the country in 2010, created the need for gradual adjustment to restore its fiscal space and keep the level of government debt within reasonable bounds. The fiscal deficit reduction began in 2011 as tax revenues recovered. The authorities envisage the recovery of fiscal space's continuing in 2012 and subsequent years, accompanied by a series of reforms enabling an increase in tax revenues, maintaining adequate levels of public spending in priority areas, and developing efficient expenditure management and transparency. It is worth noting that the Government managed to approve a package of tax reforms in early 2012, the implementation of which is expected increase tax revenues by around 1% to 1.5% of GDP from 2013 onward.<sup>86</sup> Moreover, Guatemala has been able to return to international markets after an absence of eight years. In late May 2012, Guatemala raised US\$700 million by issuing ten-year sovereign bonds on international markets, at an interest rate of 5.75%.<sup>87</sup>

**Medium-term financing requirements.** The Central Government has decreasing financing needs, in line with the gradual drop in the fiscal deficit over the medium term. For 2012 external financing needs are set to reach 1.4% of GDP, dropping to 1.2% of GDP in 2013-14.<sup>88</sup> External financing needs are projected to fall considerable in subsequent years, as the debt management strategy aims to shift reliance onto domestic borrowing. Nevertheless, Guatemala's economy is vulnerable to external shocks, such that a deterioration in the global environment could lead to increased borrowing needs, and increased demand for external funding, in particular.

**Guatemala: Borrowing Requirement (Central Government)\***

	2012 1/	2013	2014	2015	2016
Fiscal deficit	2.4	2.2	2.0	1.9	1.7
Net borrowing	2.4	2.2	2.0	1.9	1.7
Net external 2/	1.4	1.2	1.2	0.4	0.3
Net internal 3/	0.9	1.1	0.7	1.4	1.4

Source: MINFIN (*Proyecto de Presupuesto General de Ingresos y Egresos del Estado para el Ejercicio Fiscal 2013* [Draft General State Income and Expense Budget for Fiscal Year 2013]) and IMF (Article IV consultation). \* Estimates.

1/ The budget approved for 2012 estimates a fiscal deficit of 2.6% of GDP.

2/ Includes loan disbursements, amortizations, and bond issues.

3/ Includes bond issues, amortizations, and government deposits.

<sup>86</sup> Provided that macroeconomic conditions remain in the base range that MINFIN has used for projections.

<sup>87</sup> This transaction represents the country's largest placement and the lowest interest rate it has obtained. Fitch Ratings gave the issue a BB+ rating.

<sup>88</sup> More borrowing via bond issues on international markets is foreseen for 2013-14.

**IDB lending framework.** The Bank is considering two scenarios for sovereign guaranteed lending. These have been designed on the basis of fiscal financing needs, the government debt management strategy, and the Guatemalan government's aggregate demand and economic growth assumptions. Both lending scenarios are tentative and subject to the availability of Bank resources and annual programming exercises. The base scenario envisages total loan approvals of US\$740 million for the country strategy period. This scenario projects a positive net flow of capital for the country (US\$365.8 million), and entails a slight reduction in the IDB's share of the country's external government debt (from 33.7% to 33.2%) during the country strategy period, with the IDB's share of multilateral debt remaining unchanged (i.e., around 46.0%). The high scenario (US\$900 million) would be presented in a context of external shocks such as a deterioration of the international economic environment or climate factors. It is assumed that this situation would lead to an increase in the fiscal deficit of half a percentage point of GDP in 2014 (trigger indicator for the high scenario).<sup>89</sup> In the high scenario, the Bank increases its exposure to the country, increasing its share of external debt from 33.7% to 34.2%, and its share of multilateral debt from 46.1% to 46.5%. Both scenarios project a reconfiguring of external debt in which sovereign bonds make up a larger share of the total, and both are consistent with the country's fiscal sustainability.

SOVEREIGN DEBT LENDING SCENARIO 2012-2016												
(US\$ Million)												
	BASE					HIGH					BASE	HIGH
	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016	TOTAL*	TOTAL*
Approvals	237.2	323.1	94.6	85.1	-	237.2	375.0	202.7	85.1	-	740.0	900.0
Disbursements	140.0	317.2	357.8	93.2	87.0	140.0	317.2	401.8	237.2	87.0	995.3	1,183.3
Repayments	100.4	104.4	124.2	138.9	139.8	100.4	104.4	124.2	138.9	139.8	409.8	409.8
Net loan flow	39.6	210.8	233.6	(45.7)	(52.8)	39.6	210.8	277.6	96.3	(52.8)	385.5	573.5
Subscriptions	4.1	3.9	3.9	3.9	3.9	4.1	3.9	3.9	3.9	3.9	19.7	19.7
Net capital flow	35.5	206.9	229.7	(49.6)	(56.7)	35.5	206.9	273.7	94.4	(56.7)	365.8	553.8
Interest total fee	83.7	83.0	83.4	81.3	82.9	83.7	83.0	84.9	87.9	88.5	414.4	429.1
Net cash flow	(48.2)	123.9	146.3	(130.9)	(139.6)	(48.2)	123.9	188.8	6.5	(146.2)	(46.6)	124.7
IDB Debt	2,153.4	2,364.1	2,597.8	2,552.1	2,499.3	2,153.4	2,364.1	2,641.8	2,740.1	2,687.3	12,166.6	12,386.6
IDB debt/GDP (%)	4.3	4.4	4.4	4.2	3.9	4.3	4.4	4.4	4.5	4.2	4.3	4.4
IDB debt/Public debt (%)	17.2	17.5	17.9	14.5	15.2	17.2	17.5	17.8	17.2	15.7	14.9	17.1
IDB debt/External debt (%)	33.7	34.2	34.3	34.8	33.2	33.7	34.2	34.0	34.2	34.2	34.5	34.9
IDB debt/Multilateral debt (%)	44.1	44.7	45.0	44.4	44.0	44.1	44.7	47.1	45.0	44.5	44.7	44.9

Source: Ministry of Public Finance, Guatemala; IDB; International Monetary Fund; World Bank; Sincrodis.

\* Average in the case of debt ratios.

In both scenarios, the aim will be to frontload approvals in the first years of the strategy so as to facilitate the startup of project execution during the corresponding country strategy period.

<sup>89</sup> Should the potential trigger be a natural disaster, the economic impact would have to be assessed to be equivalent of at least half a point of GDP for this to take effect.

## **COORDINATION WITH OTHER DONORS**

The country strategy has been designed and developed in close collaboration with the World Bank (WB). These cooperation efforts date back to before the current government took office, and began with a first meeting held with it in January 2012. At this meeting, the WB and IDB presented diagnostic assessments of the country's challenges and joint actions to be taken to address them in some areas. The dialogue has been ongoing since this first meeting, culminating in the IDB's presence at the technical/management meeting presenting the WB strategy to its top management in July.

The specific areas in which greater coordination or work in partnership are envisaged are: fiscal and municipal management, rural development (productive development and health), social protection, peaceful coexistence and citizen security, and transportation.

Additionally, a joint working team has also been established with the WB to analyze the execution challenges both institutions faced by both institutions in implementing their programs. Although cooperation in this area has begun, it is expected to be formalized with the official appointment of a team and setting of a timetable. Once this has been done, the priority objectives will be identified, and a work plan prepared. This coordinated strategy is expected to be the first step towards even closer partnership between the two institutions.

Thus, the Bank is taking part in the technical coordination forums created by the government jointly with the "G-13 Donors Group," as well as meetings of the Dialogue Group, a high-level G-13 body that aims to ensure effective coordination with other cooperation agencies.

The main areas where the Bank has been working jointly with other cooperation agencies are: (i) rural development, with the WB; (ii) remediation of watersheds, with the Organization of Petroleum Exporting Countries (OPEC); (iii) climate change adaptation and mitigation support, with the German government development bank, KfW Bankengruppe; (iv) improvement of health and nutrition service quality and access, with the WB; and (v) rural water and sanitation, with the Spanish Agency for International Development Cooperation (AECID). Coordination and collaboration with the community of bilateral and multilateral actors operating in the country is expected to continue over the country strategy period, particularly in the case of the WB.





## RECOMMENDATIONS OF THE OVE COUNTRY PROGRAM EVALUATION

CPE Recommendations	Management response
<p><b>Maintain the strategy design approach envisaged in the pilot initiative.</b> The pilot initiative was selective in choosing a small number of intervention areas on which it targeted and concentrated its assistance efforts. Groups of operations were designed around these areas and focused on achieving the proposed strategic development goals. This approach produced significant synergies and improved the Bank's positioning.</p>	<p><b>Agree.</b> Management will work toward developing a country strategy focused on overcoming the country's major development challenges, following the methodology developed by VPC in the last few years. This methodology makes it possible to maintain the framework of the pilot initiative and adopt a multisector approach that takes into account the Bank's experience, knowledge, and potential comparative advantages with respect to other development agencies.</p>
<p><b>Maintain the use of investment instruments in key sectors where the Bank has demonstrated its capacity to add value.</b> The main constraints on growth identified in the 2008-2011 Strategy—the State's limited capacity to generate sufficient fiscal revenues, inadequate human capital as a result of inequity, childhood malnutrition, limitations on basic infrastructure in rural areas, and high violence and crime rates—continue to impede long-term development. These are areas that, should the Guatemalan government so decide, the Bank should continue to support.</p>	<p><b>Partially agree.</b> During implementation of the next country strategy, the Bank will maintain the use of financing instruments in those sectors identified as priorities by the Bank and the country's new government (which may not necessarily be limited to the sectors listed in the recommendation). Among the factors that will determine the selection of intervention sectors, the new analyses of development challenges as the new country strategy is prepared will be taken into account. The Bank will make efforts to promote the areas mentioned by OVE in the dialogue with the country.</p>
<p><b>Match the portfolio size to the country's institutional capacity and support the country in overcoming the institutional weaknesses that limit timely use of resources.</b> It is recommended that the Manager of CID, jointly with the Guatemalan government, decide which operations to keep in the portfolio, after identifying the sectors in which the Bank will support the new administration. The operations maintained in the portfolio must be submitted to the Congress for authorization where necessary; operations that the new administration does not perceive as priorities should be cancelled.</p>	<p><b>Agree.</b> Policy dialogue with the new authorities will include an analysis of the country's absorption capacity in terms of macroeconomic stability and an evaluation of the portfolio under execution, taking into account sector execution capacity, the portfolio's relevance in the context of the 2012-2016 strategy, and its potential adjustment needs. Any decisions related to cancellations will be made in the context of annual programming exercises during implementation of the next country strategy.</p>

CPE Recommendations	Management response
<p><b>Minimize the use of waivers when PBLs are used.</b> To ensure that the PBLs achieve the envisaged objectives it is vital that the proposed conditionalities agreed upon in the loan contracts be met. For this reason, the use of waivers must be avoided—especially in cases where the waiver is associated with key conditionalities since, by disbursing the resources, the Bank loses the capacity to support achievement of the operation’s development objectives. The use of PBLs must also be limited to promoting policy changes. These instruments should be coupled with complementary operations to ensure that the objectives are achieved—this support was appropriately addressed in the 2008-2011 Strategy.</p>	<p><b>Partially agree.</b> PBLs help to develop a country’s capacity to manage the process of policy reform and institutional change, lowering transaction costs associated with external assistance while simultaneously offering timely disbursement of resources for the national budget, and creating a significant incentive to approve and implement complex policy reforms. In this context, the Bank’s Management should have sufficient margin to make changes in the structure of the operations (i.e., transition from two to three tranches for the social PBL) or even to assess potential waivers in specific cases if this contributes to the achievement of the desired medium- or long-term goals.</p> <p>In the case of Guatemala, PBLs have focused on advancing to essential policy areas: Fiscal reform and social policy. In both cases, PBLs successfully supported dialogue and policy implementation. The Human Capital Investment Program (GU-L1017) helped, along with other factors, to improve living conditions for the poorest segment of the population and to raise vaccination and schooling rates in the target population.</p> <p>The Program to Strengthen Public Finances (GU-L1020), in addition to its achievements in terms of expenditure quality and tax administration, lay the groundwork for approval of the fiscal reform, which took place this past February (“Ley de Actualización Tributaria” [Tax Reform Law]), expected to yield approximately 1% of GDP).</p> <p>PBL GU-L1020 contributed to the technical design of the approved reform, while the implementation of the remaining conditions paved the way for the approval of the law, as the Guatemalan government has formally acknowledged.</p> <p>This case shows that, even if the political timing and the timing of policy-based loan execution are not fully synchronized, this type of instrument makes it possible to support reforms that are of crucial importance to the country and create significant long-term effects.</p>

## DEVELOPMENT EFFECTIVENESS MATRIX – SUMMARY

### COUNTRY STRATEGY: GUATEMALA 2012-2016

**STRATEGIC ALIGNMENT** (measures two dimensions: (i) the extent to which the strategy's objectives are consistent with the country's development challenges and the government's priorities and plans; and (ii) the use of a mix of products (financial, knowledge, technical assistance) to attain the objectives, and identification of other cooperation agencies and their areas of action).

Consistency of strategic objectives: The Strategy is structured along two axes, the first institutional, covering the (i) fiscal and municipal management, (ii) social protection, and (iii) peaceful coexistence and citizen security areas; and the second addressing rural development, including the areas of (iv) productive development, (v) health, and (vi) transportation. The topics of climate change adaptation and mitigation, disaster impact mitigation, indigenous peoples and gender, will be addressed as crosscutting issues in the strategy. All the areas selected address the country's development challenges and are consistent with the priorities set by the Government of Guatemala. In addition, the work areas result from the dialogue between the country and the Bank.

Mix of products and participation by other donors: The strategy proposes to use different Bank instruments, such as SG operations, NSG operations, and TC operations. The strategy takes into account interventions by other multilateral cooperation agencies including USAID, CABEL, FAO, and others, and has been designed and prepared in close cooperation with the World Bank.

**EFFECTIVENESS** (measures whether the country strategy is likely to achieve its intended objectives, through an examination of four dimensions of effectiveness: (i) quality of the diagnoses on which the Bank's action rests in each area of work; (ii) the quality of the strategy results framework; (iii) the use and strengthening of country systems; and (iv) the analysis of the lending framework):

Effectiveness dimensions	%
I. Sector diagnostics	
- Identifies the main problems based on empirical evidence	100
- Identifies the main beneficiaries	100
- Identifies and measures the factors that contribute to the problems identified	100
- Presents the policy framework and a sequence for Bank intervention	100
- The diagnostic corresponds to the objectives presented in the strategy	100
II. Results matrix	
- The expected outcomes are clearly defined	100
- The indicators are outcome indicators and are SMART	90
- The indicators have baselines	95

Nine sector notes were submitted to support the strategy.

All were validated

- 100% of the notes clearly identify the main sector problems based on empirical evidence.
- 100% of the notes identify the potential beneficiaries in each area of intervention.
- 100% of the notes identify or measure the factors that contribute to the problems identified.
- 100% of the notes identify the policy framework and sequence for Bank actions.
- In 100% of the notes, there is consistency between the note and the strategic objectives.

Results matrix:

- 100% of the strategic objectives clearly identify expected outcomes;
- 90% of the indicators used are outcome indicators and are SMART.
- 95% of the indicators have baselines.

Country systems: All financial management and procurement subsystems have been assessed. Various strengthening actions are envisaged for some of the financial management and procurement subsystems. Some of the financial management and procurement subsystems will be used during the strategy period.

Lending framework: the strategy contains an analysis of the country's financing requirements, and provides an estimate of the amount of financing that could be provided by the Bank. The lending framework is consistent with the macroeconomic projections and the country's financing strategy.

**RISKS** (measures three dimensions: (i) identification of factors that actually do or might affect the attainment of the proposed objectives; (ii) definition of mitigation measures, and (iii) monitoring mechanisms):

The strategy identifies risks associated with the Bank's involvement in each of the strategic sectors and identifies mitigation measures. It also identifies macroeconomic and implementation risks.