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THE INTER-AMERICAN INVESTMENT CORPORATION

**GUATEMALA**

**IDB GROUP COUNTRY STRATEGY  
2017-2020**

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## CONTENTS

EXECUTIVE SUMMARY .....	iii
I. CONTEXT .....	1
II. BANK PRESENCE IN THE COUNTRY .....	3
III. PRIORITY AREAS .....	8
IV. ESTIMATED LENDING FRAMEWORK .....	23
V. STRATEGY IMPLEMENTATION .....	24
VI. RISKS .....	26

### ANNEXES

- I. Indicative Results Matrix
- II. Main Economic and Social Indicators
- III. Estimated Lending Framework
- IV. Development Effectiveness Matrix
- V. Management's Response to the Country Program Evaluation: Guatemala 2012-2016

### ELECTRONIC LINKS

- [Guatemala: Country Development Challenges 2016](#)
- [Fiduciary Technical Note](#)
- [Portfolio Report](#)
- [Consultation with Civil Society](#)
- [Coordination with Other Donors](#)
- [2016-2020 General Government Policy](#)
- [Plan of the Alliance for Prosperity in the Northern Triangle](#)
- [Outstanding Bank Portfolio in the Territories Given Priority in the Plan of the Alliance for Prosperity in the Northern Triangle](#)

## ABBREVIATIONS

AECID	Spanish Agency for International Development Cooperation
CCT	Conditional Cash Transfers
CGC	Contraloría General de Cuentas [Office of the Comptroller General]
CICIG	International Commission against Impunity in Guatemala
CIMA	Centro de Información para la Mejora de los Aprendizajes [Learning Improvement Information Center]
CPE	Country Program Evaluation
ECLAC	Economic Commission for Latin America and the Caribbean
ENCOVI	Living Standards Survey
ENSMI	National Maternal and Child Health Survey
FAO	Food and Agricultural Organization
FATF	Financial Action Task Force
IPSAS	International Public Sector Accounting Standards
MAPS	Methodology for Assessing Procurement Systems
MEM	Ministry of Energy and Mines
MER	Mercado Eléctrico Regional [Regional Electrical Market]
MINEDUC	Ministry of Education
MINFIN	Ministry of Public Finance
MSMEs	Micro, Small, and Medium-sized Enterprises
MSPAS	Ministry of Public Health and Social Welfare
OECD/DAC	Organization for Economic Cooperation and Development/Development Assistance Committee
OTA	Office of Technical Assistance, U.S. Department of the Treasury
OVE	Office of Evaluation and Oversight
PAPTN	Plan of the Alliance for Prosperity in the Northern Triangle
PBLs	Policy-based Loans
PMR	Project Management Report
SAT	Superintendencia de Administración Tributaria [Office of the Superintendent of Tax Administration]
SEGEPLAN	Secretaría de Planificación y Programación de la Presidencia [Planning and Programming Secretariat, Office of the President of Guatemala]
SMEs	Small and Medium-sized Enterprises
TFFP	Trade Finance Facilitation Program
USAID	United States Agency for International Development

## EXECUTIVE SUMMARY

<b>Economic and social context</b>	Guatemala is undergoing a process of political and social change as a result of investigations into corruption in tax administration and public procurement carried out by the Public Prosecutor's Office with the support of the International Commission against Impunity in Guatemala (CICIG). In this context, the new government has given priority to strengthening revenue collection capacity and improving transparency in public management in order to tackle structural development problems such as the high rates of poverty and inequity that have historically plagued the country. Guatemala maintained moderate average annual growth of 3.7% between 2011 and 2016 due, among other reasons, to low levels of productivity, human capital, and infrastructure investment. Thus, little progress has been made in addressing social challenges. The poverty rate increased by 5.6 percentage points between 2011 and 2014 to 59.3% of the total population. The incidence of poverty is more acute among the indigenous and rural populations, segments in which it reaches 79.2% and 76.1%, respectively. These populations have limited access to social services, which reduces their ability to accumulate human capital and participate in the economy.
<b>The IDB in Guatemala</b>	The Bank's Country Strategy with Guatemala 2012-2016 revolved around two axes: the <i>Institutional axis</i> , which encompassed the areas of (i) Fiscal and municipal management, (ii) Social protection, and (iii) Peaceful coexistence and citizen security; and the <i>Rural development axis</i> , which addressed the issues of: (i) Productive development, (ii) Health, and (iii) Transportation. The crosscutting areas were: climate change adaptation and mitigation, natural disasters, indigenous peoples and gender, and regional integration, with emphasis on transportation and energy. Over the country strategy period, six sovereign guaranteed loans totaling US\$999 million were approved. In addition, the Inter-American Investment Corporation (IIC) approved a total of 47 operations amounting to US\$628 million. Sovereign guaranteed loan disbursements during this same period amounted to US\$738 million.
<b>Priority issues</b>	The 2017–2020 <sup>1</sup> country strategy will focus on three pillars: (i) improving public management and transparency; (ii) reducing poverty and inequality; and (iii) private sector development. The country strategy will give priority to addressing factors limiting the execution of programs, defining new implementation mechanisms applicable both to the active portfolio and future programs. Particular attention will be given to rural and indigenous populations, incorporating cultural relevance and gender equality measures, as applicable, as well as including climate change adaptation measures with a multisector approach. In addition, the territories prioritized under the Plan of the Alliance for Prosperity in the Northern Triangle will be used to maximize synergies with the country strategy. This strategy supports the principal development challenges identified in the 2016-2020 General Government Policy (PGG) and is aligned with the Update to the Institutional Strategy (UIS) 2010-2020, and with the Business Plan of the Inter-American Investment Corporation (IIC). <sup>2</sup>
<b>Lending framework</b>	Estimated support for the period 2017-2020 would be approximately \$521 million in sovereign guaranteed approvals, while disbursements are estimated at US\$650 million. Progress on portfolio execution will be the main factor to take into account in the programming dialogue for new operations.
<b>Main risks</b>	The main risks to implementation of the strategy are: (i) execution risk, related to the capacities of local counterparts and weaknesses in the design of programs; (ii) political risks, related to delays in procedures for legislative ratification of the Bank's programs due to a highly fragmented Congress and high turnover of government officials; and (iii) risks arising from the potential occurrence of natural disasters.

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<sup>1</sup> This country strategy will remain in effect until December 2020.

<sup>2</sup> IIC. "IIC Business Plan, 2017-2020," document CII/GA-77-2, 2016.

## I. CONTEXT

- 1.1 In recent years, Guatemala has been undergoing a process of political and social change, spurred by the population's unrest after the prosecutor's office, with support from the CICIG,<sup>3</sup> revealed serious cases of corruption in public administration in the areas of taxation and procurement. Based on this context, the main priority of the Guatemalan government that took office in January 2016 is to strengthen revenue collection capacity and improve transparency in public management, in order to rebuild confidence and generate fiscal leeway for tackling the structural development challenges that have historically plagued the country, such as high rates of poverty and inequality and governance issues.
- 1.2 Guatemala has maintained moderate and stable growth in recent years, although not enough to make progress on its social challenges. Between 2011 and 2016, the economy posted average growth of 3.7%, higher than the average for Latin America and the Caribbean of 1.8%, driven primarily by the service and manufacturing sectors.<sup>4</sup> Nonetheless, moderate growth in conjunction with rapid population growth have prevented the country from making significant improvement in per capita income, which has remained stagnant compared to the rest of the region. In fact, growth of per capita GDP has been slowing continuously, falling from an average of 1.7% during the 1990s to 1% over the last five years.<sup>5</sup>
- 1.3 In this context, poverty has worsened and inequality remains among the highest in the region. Between 2011 and 2016, poverty increased by 5.6 percentage points, to 59.3% of the total population. The incidence of poverty is more acute among the indigenous and rural populations, where it reaches 79.2% and 76.1%, respectively. These two socioeconomic conditions are highly correlated, since nine out of ten indigenous inhabitants in rural areas live in poverty. Guatemala is among the countries with the highest inequality in the region, with a Gini coefficient of 0.55 in 2014, compared to 0.49 for Latin America and the Caribbean in the same year.
- 1.4 The pattern of economic growth and increased poverty seen in Guatemala is primarily due to job creation concentrated in highly informal sectors, social exclusion, and tax-related considerations. It is estimated that two-thirds of workers are informally employed in sectors such as agriculture and trade, and most of these workers are rural and belong to low-income indigenous groups. At the same time, limited access to education and health services, particularly among the poorest population, limits their ability to access better quality jobs and escape from poverty. This situation is exacerbated by the fiscal dynamics, since the government's low tax collection capacity limits the ability to adequately provide quality public services.
- 1.5 Limited access to basic public services and productive infrastructure impedes the economic inclusion and social mobility of the most vulnerable population. Gaps in access and quality arise due to geographic location (rural vs. urban) and ethnicity

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<sup>3</sup> The CICIG was ratified by the Congress of the Republic in 2007 and is an independent international body the purpose of which is to support the Public Prosecutor's Office, the National Civil Police, and other government institutions in the investigation and dismantling of crimes committed by members of illegal security services and clandestine security organizations.

<sup>4</sup> The services sector grew by 5.1% per year, with emphasis on financial intermediation and private services, followed by manufacturing (3.3%), driven by the food and beverages industry and textile production.

<sup>5</sup> Per capita GDP as of 2015 of US\$7,706.70 PPP.

(indigenous vs. Ladino). Nearly half of the country's children under the age of five suffer from chronic malnutrition, which affects 61% in the case of the indigenous population. In addition, net coverage of preschool and primary education at 51.1% and 90.1% respectively, together with high child malnutrition, limit human development from the earliest stages of the life cycle. Access to basic water and sanitation services is also limited for poor rural populations and indigenous communities. This situation, in combination with limited quality job opportunities and the interior rural areas' disconnect with the country's production chains, helps to perpetuate the conditions of poverty, exclusion, social risk, and emigration, primarily to the United States.<sup>6</sup>

- 1.6 The persistence of these shortfalls reflects institutional weaknesses that restrict the government's ability to implement the public policies needed. On the fiscal level, these weaknesses are evidenced by low tax revenues, which amounted to 10.4% of GDP in 2016, 15 percentage points below the average for the rest of Latin America and the Caribbean. Low tax revenues, together with a fiscal policy that has prioritized low government debt,<sup>7</sup> has limited the government's ability to finance the country's development needs. Thus, public spending amounted to 12.1% of GDP in 2016, far below the average of 32.9% in other Latin American and Caribbean countries, a level that is insufficient to address the significant social and infrastructure challenges facing the country. This problem is exacerbated given the low levels of effectiveness and transparency shown in spending.<sup>8</sup> Weaknesses in the administration of justice<sup>9</sup> have contributed not only to a high incidence of corruption, but also to high levels of violence and citizen insecurity, affecting the population's quality of life and limiting the ability to attract the investments needed to generate more and better employment opportunities.
- 1.7 To resolve these weaknesses in the institutional framework, the Guatemalan government is implementing reforms that seek to strengthen revenue collection capacity and improve transparency in public management. In December 2015, the Congress approved a reform of the Contracting Law, designed to strengthen governance and transparency in public procurement.<sup>10</sup> In addition, legal changes have been introduced to increase the independence of the Public Prosecutor's Office<sup>11</sup> and strengthen the accountability of the Congress and political parties.<sup>12</sup> The

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<sup>6</sup> International Organization for Migration. "Perfil migratorio de Guatemala 2012," Guatemala, 2013.

<sup>7</sup> Public debt amounted to 24% of GDP in 2016 while the average was 56% of GDP in Latin America and the Caribbean.

<sup>8</sup> Izquierdo *et al.* show that there are leaks in social welfare spending equivalent to 0.8% of GDP. Izquierdo, A., R. Loo-Kung, F. Navajas. "Resistiendo el canto de las sirenas financieras en Centroamérica." CID-IDB Macroeconomic Report, 2013.

<sup>9</sup> According to the World Justice Project (2015) ranking, Guatemala is one of the countries with the least effective criminal justice system, placing 95th out of a total of 102 countries analyzed.

<sup>10</sup> The principle measures included in the reform are: prohibition on contracts with companies linked to civil servants and funders of political campaigns, introduction of the reverse auction mechanism, and establishment of penalties for uncompetitive practices in the provision of goods and services.

<sup>11</sup> The new law governing the Public Prosecutor's Office, approved in February 2016, limits discretion for removal of the Public Prosecutor, grants him or her power to appoint judges and strengthen criminal investigation, and is more specific regarding disciplinary actions for irregular conduct by prosecutors.

<sup>12</sup> Penalties when representatives switch parties, establishment of mechanisms for selection and promotion of public officials in Congress based on merit, and the requirement that political parties provide information on the private and public contributions they receive.

new government also took emergency measures to regain control of the Superintendencia de Administración Tributaria [Office of the Superintendent of Tax Administration] (SAT), including amending its implementing law to strengthen its governance and revenue collection capacity, appointing a new Superintendent and a new Board, and replacing the institution's management team.

- 1.8 In this context, the 2016-2020 PGG prioritizes zero tolerance for corruption and modernization of the state among its targets for the period. The policy includes five areas of work: (i) transparency; (ii) health; (iii) education; (iv) economic development; and (v) citizen security, which are framed by the guidelines established in the Plan Nacional de Desarrollo K'atun 2032 [K'atun 2032 National Development Plan].<sup>13</sup>

## II. BANK PRESENCE IN THE COUNTRY

- 2.1 The priority areas of the Bank's 2016-2016 country strategy revolved around two axes: an institutional axis and a rural development axis. The institutional axis included the priority intervention areas of: (i) Fiscal and municipal management; (ii) Social protection; and (iii) Peaceful coexistence and citizen security. The rural development axis suggested a place-based approach in the following areas: (i) productive development; (ii) health; and (iii) transportation. The country strategy worked on a crosscutting basis with respect to: climate change adaptation and mitigation; natural disaster impact mitigation; indigenous peoples and gender; and regional integration. The education and energy sectors were areas of dialogue.
- 2.2 Under these axes, the Bank approved six **sovereign guaranteed** loans were approved for US\$1 billion<sup>14</sup> during the period 2012-2016, three investment loans and three policy-based loans (PBLs) in the areas of fiscal management (US\$487 million), social protection (US\$250 million), rural electrification<sup>15</sup> (US\$55 million), education (US\$150 million), and modernization of the Public Prosecutor's Office (US\$60 million). These operations were added to a portfolio of 19 operations with a balance of US\$663.2 million being executed during the country strategy period. Disbursements recorded during this same period amounted to US\$738 million.
- 2.3 Approvals of the **Inter-American Investment Corporation (IIC)** amounted to US\$628 million for 47 operations, consisting of: (i) US\$202 million in loans intended primarily for financial intermediation, energy, and textiles; (ii) US\$426 million in credit lines under the Trade Finance Facilitation Program (TFFP), one quarter of which supported small and medium enterprises (SMEs) in agroindustries and manufacturing. The Multilateral Investment Fund (MIF) approved five Social Entrepreneurship Program loans for US\$2.6 million in the areas of productive chains and microfinance.

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<sup>13</sup> Approved by the Guatemalan government in 2014 as a national long-term development policy coordinating policies, plans, programs, projects, and investments planned up to 2032.

<sup>14</sup> Includes operations as of 17 December 2012, when the strategy was approved by the IDB Board of Executive Directors, until December 2016. The area of fiscal management, given its contribution to the results matrix of the 2012-2016 strategy, includes the operation "Fiscal Consolidation Program for Guatemala (GU-L1064)," approved in July 2012.

<sup>15</sup> Loan canceled in June 2017 when the Guatemalan Congress failed to approve it.

- 2.4 Financing was accompanied by **technical assistance**, including US\$31 million in technical cooperation funding and investment grants in the priority and crosscutting areas of: health, climate change, gender and diversity, social protection, and fiscal and municipal management.<sup>16</sup> In addition, the MIF approved 20 nonreimbursable technical-cooperation operations for US\$16 million focused on: (i) improving access to markets and financing, as well as the capacities of rural small and medium-sized enterprises, most of them community-based; (ii) providing nutrition services to indigenous populations in the dry corridor; (iii) developing financial services associated with the flow of remittances; and (iv) supporting renewable energy initiatives in rural areas.
- 2.5 **Main results in the context of the 2012-2016 country strategy.**<sup>17</sup> In a complex institutional context that affected portfolio execution, the IDB Group supported reform processes and helped to maintain investment in priority sectors for the country's development, as described below.<sup>18</sup>
- 2.6 Reforms were supported under the institutional axis in the areas of social protection and fiscal and municipal management. In the area of *social protection*,<sup>19</sup> the Bank supported the government in implementing measures to improve the effectiveness of social spending, in order to improve its indicators in nutrition, maternal-child health, and educational progress, notably improving the targeting of social protection programs and making operational progress in the *Mi Bono Seguro* conditional transfer program, such as, for example, beneficiary eligibility criteria, increasing management capacity in the delivery of maternal-child health services, increasing the coverage of services related to the prevention of chronic malnutrition and neonatal mortality, and strengthening the skills of health services providers and primary education teachers.<sup>20</sup>
- 2.7 In the area of *fiscal and municipal management*, support was provided for approval of comprehensive tax reform,<sup>21</sup> the objective of which was to increase revenue collection and broaden the tax base. The promoted reforms notably include approval of the broadening of the tax base, simplification of income tax, and approval of two important laws, the Tax Reform Law and the Anti-evasion Law II, which introduced measures increasing the powers of the SAT to strengthen tax enforcement. These reforms helped to increase tax revenues by 0.2 percentage points of GDP between

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<sup>16</sup> In the context of non-sovereign guaranteed operations, five nonreimbursable technical-cooperation operations were approved for US\$400,000 to support energy efficiency and renewable energy projects, as well as sustainable forest management.

<sup>17</sup> Includes results achieved during the 2012-2016 period based on the portfolio being executed, as well as approvals during the country strategy period.

<sup>18</sup> During implementation of the 2012-2016 country strategy, the age of the portfolio increased from 4.5 years in 2011 to 6.2 years in 2016, which is related to the time it takes for operations to take effect (19.9 months) and the fact that 42% of the portfolio is classified as a problem project or on alert status according to the PMR.

<sup>19</sup> Program to Improve Social Spending Allocation and Effectiveness (GU-L1085).

<sup>20</sup> Specific results: inclusion of 19,491 women heads of household in the *Mi Bono Seguro* program who were excluded for not having a unique identification number; 0.35% change between 2014 and 2015 in the rate of women of childbearing age who receive micronutrient supplements. For more information, see: Project Completion Report for the Program to Improve Social Spending Allocation and Effectiveness (GU-L1085).

<sup>21</sup> Fiscal Consolidation Program for Guatemala (GU-L1064).

2012 and 2013, which was less than initially expected (1 percentage point of GDP),<sup>22</sup> but prevented government revenues from falling during the period.<sup>23</sup> This process was not accompanied by the necessary institutional improvements in the SAT, yet despite this, the actual number of taxpayers who made direct payments to the SAT increased by 15% between 2011 and 2014.

- 2.8 Under the Rural Development axis, *health*<sup>24</sup> programs supported the country's efforts to reduce maternal and neonatal mortality and chronic childhood malnutrition through increased supply and quality improvements in basic services, serving a half million rural inhabitants through mobile medical groups, including 22,000 children under the age of five and 7,947 pregnant women. In terms of infrastructure, nine departmental hospitals were rehabilitated and equipped,<sup>25</sup> while the originally planned construction, rehabilitation, and equipping of 55 primary health care clinics experienced delays, and a reduction in the target is anticipated given the context of high turnover of officials and adjustments in the health services delivery model at that level during the strategy implementation period. In the area of dialogue on education, the Bank helped to increase *educational*<sup>26</sup> coverage at the preschool and primary level, improve the infrastructure of 3,400 schools in the municipios of the Zero Hunger Plan,<sup>27</sup> and train 15,000 teachers in reading, mathematics, and values programs, as planned.
- 2.9 In terms of the rural development approach proposed in the 2012-2016 strategy, which aimed to coordinate multisector actions geographically, the Bank's support for the Chixoy region,<sup>28</sup> located in the departments of Baja Verapaz, Alta Verapaz, and Quiché and consisting of approximately 11,000 people belonging to the Achí, Poqomchí, and Ladina communities, represents an effort to: (i) promote community participation and social management in the planning and delivery of services in coordination with the municipios; (ii) incorporate improvements in the supply of basic social services; (iii) facilitate access to productive assets; and (iv) promote job options in a territory. In concrete terms, support was provided for the delivery of health and childhood nutrition services, with equipment and improvements in nine health centers; 20 primary schools were rehabilitated; the region's connectivity was improved with the government's technical support for the construction of the Chitomax pedestrian bridge;<sup>29</sup> *electricity coverage* was expanded in 16 communities;<sup>30</sup> and ten basic *water and sanitation* systems were

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<sup>22</sup> Following approval of the law, the Constitutional Court found some articles to be unconstitutional while the government made additional adjustments to the law that together affected the original scope of the reforms.

<sup>23</sup> World Bank. "Guatemala Economic DNA," 2014. Cabrera, M. "Análisis de la implementación de la reforma tributaria de Guatemala," 2012. Economic Commission for Latin America and the Caribbean (ECLAC), 2014.

<sup>24</sup> Program to Strengthen the Hospital System (GU-L1009), Improved Access and Quality of Health and Nutrition Services Program (GU-L1022), and Mesoamerican Health Initiative 2015 (GU-G1001).

<sup>25</sup> San Marcos, Mazatenango, Quezaltenango (2), Sololá, Huehuetenango, Quiché, Totonicapán, and Retalhuleu.

<sup>26</sup> Mi Escuela Progresá (My School is Making Progress) Program (GU-L1023).

<sup>27</sup> The plan focuses on 166 municipios where there is a high prevalence of chronic malnutrition. Of this total, more than 60% of the municipios are located in rural and indigenous areas.

<sup>28</sup> The IDB Group's support was provided within the framework of the Guatemalan government's "Government Agreement for Public Policy on Reparation."

<sup>29</sup> Project to Support the Rural Economic Development Program (GU-L1006).

<sup>30</sup> Multiphase Rural Electrification Program (GU-L1018).

- designed. Through the MIF, various actions were carried out with respect to the preservation and dissemination of the Maya Achi culture, including anthropological research; training of 190 young people and women; fairs, exhibitions, and dissemination events; and improvements in the Community Museum of Rabinal, which achieved an 18% increase in annual visits. The materialization of these results, achieved during the strategy, reflects the multisector approach promoted in coordination with the government.
- 2.10 Non-sovereign guaranteed operations supplement the actions of the IDB's public sector window through productive development interventions with an inclusive perspective, seeking to increase rural per capita income and diversify household income sources, all through increased access to credit, improved access to markets, and actions to create jobs for the most vulnerable sectors. Notable results include:<sup>31</sup> (i) access to financing for 54,885 micro, small, and medium-sized enterprises (MSMEs) through local financial agents;<sup>32</sup> (ii) support to 820 companies (including 645 SMEs) to carry out foreign trade transactions through the TFFP program; (iii) the creation of 1,527 jobs; (iv) improved housing conditions for more than 3,000 people living in areas with high social vulnerability; (v) support for the country in negotiating and signing seven free trade agreements; and (vi) the design of the national competition policy.
- 2.11 Efforts were made through the MIF to improve rural and indigenous populations' access to basic services and productive chains. As a result, more than 2,000 households received access to electricity; the value chains for cardamom, coffee, vegetables, and beekeeping products were strengthened, benefiting more than 10,000 rural producers; 16 costume jewelry companies led by women were created with access to responsible international markets, generating about 400 jobs; and a geographical model of climate change adaptation was developed, benefiting 130 Chortí communities in the dry corridor region.
- 2.12 Actions in the area of climate change and natural resources supported: the development of the platform for Reducing Emissions from Deforestation and Forest Degradation (REDD+); planning of investments under the country's forest investment program; creation of the national climate change plan as a tool for the mainstreaming of climate change in the policy planning and development process;<sup>33</sup> the registry of more than 23,000 square kilometers of protected natural areas located in the Maya Biosphere Reserve; as well as the registration of 32 protected areas in the General Property Register.<sup>34</sup> In addition, the medium- and long-term plan for the sustainable management of the Lake Amatitlán watershed was updated, seeking to reverse the environmental deterioration of the watershed and the lake.<sup>35</sup> Resources

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<sup>31</sup> Results from the Program to Support Strategic Investments and Productive Transformation (GU0163) and the Trade and Integration Support Program (GU-L1037) are included.

<sup>32</sup> Banco de Desarrollo Rural (GU-L1010), Banco G&T (GU-L1040), Banco Industrial (GU-L1079), and Banco Continental (GU-L1067).

<sup>33</sup> Preparation of the National Strategy for Reducing Emissions through Avoided Deforestation and Forest Degradation in Guatemala (GU-T1194), Preparation of the Forest Investment Program Investment Plan in Guatemala (GU-T1257), and Support to the Climate Change Group in the Planning and Programming Secretariat, Office of the President of Guatemala (SEGEPLAN) (GU-T1222).

<sup>34</sup> Petén Development Program for the Conservation of the Maya Biosphere Reserve (GU-L1002) and Establishing Cadastral Registry and Strengthening Legal Certainty in Protected Areas (GU-L1014).

<sup>35</sup> Program for the Environmental Restoration of the Lake Amatitlán Watershed (GU0066).

were also redirected from the portfolio to support the reconstruction of the affected infrastructure and implement a plan for economic revitalization following the 2012 earthquake.<sup>36</sup>

- 2.13 **Outstanding portfolio.** As of 30 April 2017, the portfolio consists of 15 sovereign guaranteed operations for US\$963 million,<sup>37</sup> with an available balance of US\$678.5 million focused on the pillars of improving public management and transparency (47.7%), reducing poverty and inequality (46.6%), and productive development (5.3%).<sup>38</sup> The IIC portfolio amounts to US\$315.9 million, concentrated in the areas of financial intermediation, support for private firms and SMEs and industry (US\$230 million), and foreign trade, through a line of credit under the TFFP (US\$45 million). The MIF has three loans for US\$1.9 million and an undisbursed balance of US\$600,000, and 19 technical cooperation operations amounting to US\$15.4 million with an available balance of US\$7.7 million, which support initiatives in climate change adaptation, agriculture, sustainable tourism, support for rural MSMEs (honey, cardamom, and vegetables for export), access to microcredit and agricultural financial inclusion, remittances and financial inclusion, as well as rural entrepreneurship with a gender approach, and microfranchises.
- 2.14 **Lessons learned.** Delays in executing the sovereign guaranteed portfolio observed during the 2012-2016 strategy implementation period reflect institutional and operational aspects,<sup>39</sup> providing three important lessons. First, the design of operations should better respond to the country's institutions and include execution mechanisms that facilitate the implementation of operations under an efficient framework. Second, approvals should be synchronized with the formulation of the government's general budget in order to avoid startup delays. Third, actions to disseminate the Bank's programs in the Congress should be increased and coordinated with the respective bodies to facilitate legislative ratification.
- 2.15 In the rural development axis, execution in rural areas was complicated due to geographic conditions, limited decentralization of public services, and providers' limited interest in executing works in those areas. In response to this, the implementation of a gradual service model through small-scale geographically targeted initiatives allowed the Bank to gain experience in approaches of this kind and to achieve results. The support provided to the Chixoy region has produced lessons emphasizing the importance of identifying, from the outset, all the stakeholders in a geographic area and their interests, including both public

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<sup>36</sup> US\$54 million were redirected from the programs on: Rural Water Investment Program (GU-0150), Program to Strengthen the Hospital System (GU-L1009) and the Mi Escuela Progresiva (My School is Making Progress) Program (GU-L1023).

<sup>37</sup> Includes a PBL for US\$250 million that will support actions to improve public management and transparency.

<sup>38</sup> The areas with the highest available balances are: fiscal management (37.2%), education (27.7%), and energy (8.1%).

<sup>39</sup> Institutional weaknesses in the local counterparts (high turnover of officials and authorities and limited interagency coordination), problems in the design of operations (multiple executing units and low preinvestment in civil works), budgetary issues (limited synchronization of loan approvals with the cycle for preparation of the government's general budget), and delays in loan approval by the Guatemalan Congress.

participation mechanisms<sup>40</sup> and the communities, their organizations, and ancestral authorities in addition to government authorities in the planning, investment, monitoring, and sustainability of the interventions. Intersector coordination in Chixoy allowed a more comprehensive approach in IDB Group actions. Specifically, activities were implemented in energy, health, education, water and sanitation, transportation, and productive enterprises, all with a gender and cultural relevance approach.

- 2.16 The lessons derived from private sector operations in rural and indigenous regions underscore the relevance of: (i) including local communities and leaders from the project design stage, particularly when there are significant socioenvironmental implications or the projects are located in areas with high social vulnerability, so as to build consensus between populations and investors regarding project benefits; (ii) taking into account the operations and/or experiences of the public sector and the MIF, in order to develop synergies that generate benefits for the communities in productive development and areas of social need; and (iii) selecting local partners with leadership and adequate fiduciary management and planning capacities.
- 2.17 The current strategy takes into account the recommendations from the 2012-2016 Country Program Evaluation (CPE) conducted by the Office of Evaluation and Oversight (OVE)<sup>41</sup> to: (i) prioritize the structural problems of governance that limit the State's effectiveness; (ii) restructure and reduce the size of the current portfolio; (iii) reorient the use of lending instruments toward achieving results; (iv) use technical cooperation principally to support the preparation and execution of loan operations; and (v) redefine the IDB Group's strategy for private sector support to focus on the main constraints to private sector development, as identified through a specific diagnostic assessment for the country.

### III. PRIORITY AREAS

- 3.1 **Strategic approach.** The Bank's 2017-2020 country strategy will prioritize strengthening public management and transparency and reducing gaps in access to basic services among the population living in poverty. In parallel, the provision of inputs that supplement private investment will be promoted. Over the medium term, the government's increased revenue collection capacity, as well as the effectiveness and transparency of public spending, will make way for investments targeting poverty reduction, generate a better environment for attracting private investment, and result in growth that benefits a larger number of Guatemalans. The implementation of this approach will be based on three pillars:<sup>42</sup> (i) Improvement of public management and transparency; (ii) Reduction of poverty and inequality; and (iii) Private sector development. The IDB Group will ensure continuity in the areas of support proposed in the previous strategy through operations now being executed, which will be part of the results proposed under this new strategic cycle, and will continue to coordinate public-private actions through the IIC and the MIF.

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<sup>40</sup> Such as the Consejos Comunitarios de Desarrollo [Community Development Councils] (COCODES), focused on promoting public participation in development planning and public management at the local level; and the Municipal Development Councils made up of local government officials, COCODES delegates, and representatives of civil society.

<sup>41</sup> The recommendations and responses provided by Management are detailed in Annex V.

<sup>42</sup> IDB. "Guatemala: Country Development Challenges," 2016.

- 3.2 The Plan of the Alliance for Prosperity in the Northern Triangle<sup>43</sup> (PAPT, Box 1) will play a guiding role in the implementation of the country strategy. Currently, the IDB has a portfolio of projects amounting to approximately US\$91 million linked to the plan's priorities and targeting the departments prioritized by the [PAPT in Guatemala](#). During the current strategy, synergies will continue to be sought between operations and the territories prioritized under the plan, as well as coordination of efforts with the IIC and other donors, in order to make a direct contribution to the strategic lines of the PAPT.<sup>44</sup>

**Box 1. Plan of the Alliance for Prosperity in the Northern Triangle (PAPT)**

In 2014, El Salvador, Guatemala, and Honduras, the countries of the Northern Triangle, formulated the PAPT in response to the significant increase in migratory flows of unaccompanied minors toward the United States. The plan seeks to offer opportunities to citizens and to lay down roots, particularly among the young population, through actions intended to: energize the productive sector, strengthen human capital, improve citizen security and access to justice, strengthen the institutional framework, and improve transparency. The member countries have worked in recent years on defining territories and prioritizing actions to be implemented within the framework of the PAPT. The Bank, in its role as the plan's Technical Secretariat, has contributed to that process and will support the initiatives agreed upon with the members countries.

**Table 1. PAPT Pillars and Lines of Action**

Productive Sector	Human Capital	Citizen Security and Access to Justice	Institutional Strengthening and Improved Transparency
Promote strategic sectors and attraction of investments	Expand and consolidate the social protection system	Expand community security and crime prevention programs	Strengthen the tax administration
Promote electrical integration	Increase coverage and improve the quality of secondary education, third and vocational cycle	Strengthen justice operators	Promote the convergence of tax systems
Improve logistical infrastructure	Improve health, nutrition, and early childhood development	Improve penitentiaries	Improve transparency and effectiveness in spending
Strengthen the regional integration process	Promote social and economic reintegration of returning migrants	Strengthen the provision of integrated services to care for the victims of violence	

Source: The authors.

- 3.3 Actions within the framework of this strategy will help to achieve the objectives of the Update to the Institutional Strategy 2010-2020 and the 2016-2019 Business Plan of the IIC, as specified under each of the pillars described below.

<sup>43</sup> The countries that make up the Northern Triangle are El Salvador, Guatemala, and Honduras.

<sup>44</sup> The actions identified will take into account, as applicable, the displaced and refugee populations residing in those municipalities.

## 1. Improvement of public management and transparency

- 3.4 The country's governance, particularly in the dimensions of corruption control, government effectiveness, regulatory quality, and voice and accountability, has deteriorated in the last decade,<sup>45</sup> affecting the government's ability to provide basic social services and make investments to foster greater economic growth. In view of this, the country's institutional framework must be strengthened in order to manage public finances with greater transparency and efficiency, and ensure the rule of law.
- 3.5 Guatemala's **public finances** have been characterized by historically low tax revenues, averaging 10.8% of GDP over the last 20 years, below the average for Latin America and the Caribbean (17.4%). In recent years, tax revenues have fallen in Guatemala, reaching a low of 10.2% of GDP in 2015, 1.9 percentage points below the maximum achieved in 2007. This reduction in public revenues has led to a two percentage point of GDP reduction in public spending over the same period, reaching 12.7% of GDP in 2015, below the 32.9% average for the rest of Latin America and the Caribbean. Structurally speaking, this situation has limited the government's ability to adequately provide basic public services and inputs supplementing the private investment required to promote more equitable economic growth and improve the situation of the most vulnerable population segments.
- 3.6 Low tax collection performance is primarily due to two factors: (i) the SAT's lack of institutional capacity to achieve efficient and effective tax collection and reduce high tax evasion gaps;<sup>46</sup> and (ii) the design of the tax system, with characterized by low personal income tax rates (between 5% and 7%) and value added tax rates (12%), compared to the Latin American and Caribbean averages of 33% and 17%, respectively.
- 3.7 The SAT's institutional capacity is affected by a series of limitations, including:<sup>47</sup> (i) a governance model with a strong private sector presence;<sup>48</sup> (ii) limited evaluation and control of officials;<sup>49</sup> (iii) fragmentation of the functions of investigation, risk analysis, and tax intelligence; (iv) low productivity of officials (average total collections per official fell by 7.3% in real terms between 2013 and 2015); and (v) vulnerability of its technological systems.<sup>50</sup> Notable deficiencies in the design of taxes include the low level of progressivity of the income tax<sup>51</sup> and its limited equity (the effective median income tax rate for the highest decile in 2014 was 1.8% compared to 4.8% in Latin

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<sup>45</sup> Between 2006 and 2015, there was deterioration in four of the six dimensions of the governance indicators. World Bank. World Governance Indicators, 2017. Available at: <http://data.worldbank.org/>.

<sup>46</sup> VAT evasion was 30% in 2014, an increase of more than four percentage points since 2012 (25.6%). For 2015, the SAT estimates that evasion reached 34.2% of potential revenue. Management of the fiscal gap is weak because the calculation is done for the VAT only and not for taxes on income and other earnings. The VAT gap is not used to improve tax intelligence actions. IDB. "Tax Management and Transparency Program (GU-L1096)," 2016.

<sup>47</sup> Idem.

<sup>48</sup> Fifty percent of the Board members belong to the private sector, which generates conflicts of interest.

<sup>49</sup> Between 2012 and 2016 fewer than 20% of officials submitted sworn statements of assets.

<sup>50</sup> Control technology in ports and airports, including weakness in invoicing control.

<sup>51</sup> In 2006, the Kakwani index was 0.29. This index measures the progressivity of the tax system. The index ranges from -1 to 1 and the higher the value, the greater the degree of progressivity. Jorrat, M. "Evaluando la equidad vertical y horizontal en el impuesto al valor agregado y el impuesto a la renta: el impacto de reformas tributarias potenciales. Los casos del Ecuador, Guatemala y el Paraguay," ECLAC, 2011.

- America and the Caribbean<sup>52</sup>). Starting in 2016, the new government launched an institutional recovery process at the SAT with the adoption of a number of measures including: (i) the approval of a law amending the Law governing the SAT, altering the composition and duties of the Board, establishing an administrative tribunal of original jurisdiction for tax and customs matters, and making significant adjustments to the entity's institutional structure; (ii) implementation of a process of restructuring and renewal of the institution's human resources; and (iii) implementation of a new fiscal intelligence and risk management model for customs and tax oversight.
- 3.8 The aforementioned challenges are related to the lack of **financial transparency** and money laundering affecting the country. Thus, the SAT's limited ability to reduce the tax evasion gaps is related to the presence of illicit financial flows and money laundering, with evasion being one of the principal offenses associated with these crimes.<sup>53</sup> This highlights the need to address the adoption of anti-money laundering rules consistent with the standards of the Financial Action Task Force (FATF) and overcome the limited availability of information on the activities of the offshore banking system.<sup>54</sup>
- 3.9 Public spending, in addition to being limited, shows low effectiveness and limited transparency, reflecting shortcomings in its management cycle, including the stages of planning, budgeting,<sup>55</sup> execution, procurement, monitoring, and evaluation.<sup>56</sup> For example, Guatemala's spending on health and education is among the lowest in the region. In 2014, it reached 2.3% and 2.8% of GDP, while the averages in Latin America and the Caribbean were 3.9% and 5%, respectively. In addition, in efficiency terms, it reaches 60% and 80% of its potential.<sup>57</sup> Spending is also affected by the frequency of natural disasters and the need to cover reconstruction requirements. Guatemala is among the ten countries in the world with the greatest exposure to natural disasters (primarily hurricanes and earthquakes). Official estimates indicate that primary extreme natural events that occurred between 1998 and 2011 produced an increase in the average fiscal deficit equal to 0.6% of GDP.<sup>58</sup>
- 3.10 Guatemala records high rates of violence and a high incidence of corruption. In 2014, the homicide rate was 31 for every 100,000 inhabitants. Although it has fallen

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<sup>52</sup> ECLAC. "Fiscal Panorama of Latin America and the Caribbean 2017: Mobilizing Resources to Finance Sustainable Development," 2017.

<sup>53</sup> Tax evasion is one of the main crimes associated with lack of financial transparency and money laundering, due to the fact that returns or transactions on which the applicable taxes were not paid are hidden from the tax authorities and must then be reintroduced into the legal economy through an asset-laundering process, so they can then be used. IDB. "Tax Management and Transparency Program (GU-L1096)," 2016.

<sup>54</sup> The recommendations of the Financial Action Task Force of Latin America (GAFILAT) include: adjustments in the legal framework for preventing money laundering, improvements in the effectiveness of the sanctions regime, and ensuring access to corporate information related to the end beneficiaries of corporations and other legal entities. GAFILAT, CFATF. "Mutual Evaluation Report of the Republic of Guatemala," 2016.

<sup>55</sup> Starting in 2016, the Ministry of Public Finance (MINFIN) launched the Open Budget process as a way to make the budgeting process more transparent. For more information see: [Presupuesto Abierto MINFIN](#).

<sup>56</sup> IDB. "Guatemala: Country Development Challenges," 2016.

<sup>57</sup> This means that, with the same level of spending, using the resources efficiently could improve the indicator results by as much as 40%. Ardanaz, M., J. Larios, C. Pérez. "El proceso presupuestario y el gasto público en Guatemala (2000-2012)," 2015.

<sup>58</sup> "Proyecto de Presupuesto General de Ingresos y Egresos del Estado para el Ejercicio Fiscal 2017 y Multianual 2017-2021." MINFIN, 2016.

compared to 2010,<sup>59</sup> it is still higher than the regional average.<sup>60</sup> As mentioned, Guatemala's indicators in the area of governance have deteriorated in recent years, particularly those related to government effectiveness and corruption control. In this latter area, Transparency International's perceived corruption index ranks the country at 123 out of 168 in 2015.<sup>61</sup> The Public Prosecutor's Office, with support from the CICIG, recently identified cases of corruption in the three branches of government. It is important to strengthen information sharing in fiscal, financial, and corporate matters in order support administrative actions and criminal investigations, primarily among the SAT, the Superintendency of Banks, and the Public Prosecutor's Office.

- 3.11 Aspects that have repercussions on the levels of violence and vulnerability to corruption include the limited effectiveness of the **justice** system, as evidenced by high rates of impunity<sup>62</sup> reaching nearly 99%.<sup>63,64</sup> The factors that weaken the effectiveness of the justice system and that are present in the various entities that make up the system<sup>65</sup> are related to:<sup>66</sup> the failure to fully implement professional careers based on merit and transparency,<sup>67</sup> lags related to low coverage of services, and limitations in institutional management. A key institution in the investigative chain is the Public Prosecutor's Office; in addition to facing these challenges, it also has limited investigative capacity (only 13 prosecutors for every 100,000 inhabitants, similar to the Central American region with 11.5 prosecutors<sup>68</sup>), limited geographical presence (serving only 10% of the population),<sup>69</sup> which affects the access to justice for populations living outside the capita—particularly the indigenous population<sup>70</sup>—as well as limited coordination among the various agencies of the security and justice system, affecting the performance of its duties.

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<sup>59</sup> In 2010, the homicide rate per 100,000 inhabitants was 41.6.

<sup>60</sup> IDB. "Guatemala: Country Development Challenges," 2016.

<sup>61</sup> Transparency International. "Corruption Perception Index," 2016.

<sup>62</sup> Impunity is understood as the failure to report, investigate, capture, and prosecute and provide positive solutions for the victims and/or convict those guilty of the offenses pursuant to Guatemalan legislation. CICIG. "Sistema de medición de la impunidad en Guatemala," 2015.

<sup>63</sup> System for Measuring Impunity in Guatemala. CICIG, 2014.

<sup>64</sup> Weaknesses in preventive control (regulation and management of conflicts of interest) and limited access to public information result in the overburdening of the criminal justice system.

<sup>65</sup> The criminal justice system consists of: the Judiciary; the Ministry of the Interior, to which the Civil National Police and the General Penitentiary System Directorate report; the Public Prosecutor's Office; and the Public Criminal Defense Institute (IDPP).

<sup>66</sup> IDB. "Guatemala: Country Development Challenges," 2016.

<sup>67</sup> Magistrates are appointed by the Congress based on proposals made by the Nomination Committees. These have been questioned as promoting the interference of corporate interests and failing to avoid politicization of the process. The short appointment period (5 years) weakens the judicial career path, inhibits professionalization, and hampers the accumulation of experience.

<sup>68</sup> IDB. "Office of the Public Prosecutor Strengthening and Modernization Program," 2016.

<sup>69</sup> The Public Prosecutor's Office has 22 district prosecutor's offices, 33 municipal prosecutor's officers, and 23 section prosecutor's offices, covering only 33% of national territory. IDB. "Guatemala: Country Development Challenges," 2016.

<sup>70</sup> As of 2015, the Judiciary, the Public Prosecutor's Office, and the IDPP had 100, 70, and 13 interpreters, respectively. Bernard, M., L. Chinchilla, A. Contreras, and O. Nazario. "Fortalecimiento del Sistema de Justicia y Estado de Derecho en Guatemala," 2016.

- 3.12 The IDB Group will support the country's efforts to improve public management and transparency based on three objectives: (i) strengthening public finances; (ii) strengthening the institutional framework for combating money laundering and corruption; and (iii) strengthening the Public Prosecutor's Office. To do this, actions will be taken to allow: (i) increased tax revenues and improved efficiency in public spending;<sup>71</sup> (ii) reduction of the country's vulnerability to money laundering, financing of terrorism, and corruption; and (iii) reduction of impunity through portfolio operations.<sup>72</sup>
- 3.13 The IDB Group's support for this pillar backs up the attention given to the challenges of social exclusion and inequality and low levels of productivity and innovation in the region under the IDB's Update to the Institutional Strategy 2010-2020, and the objectives of strengthening the government's capacity, establishing suitable institutional frameworks, and creating a more distributional tax policy.

## 2. Reducing poverty and inequality

- 3.14 The recent increase in poverty (5.6 percentage points between 2011 and 2014), together with setbacks in the coverage of basic social services in health and education require that the country's limited public investment<sup>73</sup> prioritize the delivery of social services in order to prevent greater gaps in that population's quality of life and lay the groundwork for inclusive and sustainable human development.
- 3.15 The country's principal challenge in the **health** sector is the level of chronic malnutrition among children under the age of five, which affects 46% of Guatemalan children,<sup>74</sup> twice the rate for Latin America and the Caribbean, and has a marked effect on rural and indigenous areas (53%).<sup>75</sup> This problem has not improved in recent years (1999-2014), during which the reduction has been limited to 0.9% per year, a rate well below that of other Latin American and Caribbean countries.<sup>76</sup> Currently, half of the children between 6 and 23 months do not have a minimum acceptable diet, 64% of children between 6 and 11 months suffer from anemia, and 56% of those between 4 and 5 months are not exclusively breast fed. Limited access to and low quality of health and nutrition services perpetuate this situation. For example, 40% of children under the age of 2 do not have a complete vaccination plan, and only half of those under age of five with respiratory problems and symptoms of diarrhea receive treatment at health facilities.<sup>77</sup> Climate variability

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<sup>71</sup> Improvement of public spending will be addressed on a crosscutting basis by: (i) targeting programs on poor populations; (ii) strengthening the institutional capacities of the Comptroller General's Office; (iii) implementing a citizen oversight mechanism that seeks to observe and document compliance with the standards and principles of effectiveness, efficiency, and transparent management of the Bank's loan proceeds; (vi) using the poverty targeting mechanisms of the Conditional Cash Transfers Programs for delivering social services to poor populations; and (v) strengthening country systems.

<sup>72</sup> Program to Support the Criminal Justice Sector (GU0177) and Office of the Public Prosecutor Strengthening and Modernization Program (GU-L1095). [Various donors](#) support the country's efforts in the judicial sector.

<sup>73</sup> The Central American average in 2012 was 12.3%. ECLAC. "Database on Social Investment," 2016.

<sup>74</sup> Encuesta Nacional de Salud Materno Infantil [National Maternal and Child Health Survey] (ENSMI), 2014-2015. Ministry of Public Health and Social Welfare (MSPAS).

<sup>75</sup> The departments with the highest rates of chronic childhood malnutrition, where the indigenous population exceeds 80% on average are: Totonicapán (70%), Quiché (69%), Huehuetenango (68%), and Sololá (66%).

<sup>76</sup> Peru (5.3%), El Salvador (4.4%), Mexico (3.3%), and Haiti (2.1%).

<sup>77</sup> IDB. "Guatemala: Country Development Challenges," 2016.

- (increased temperatures and droughts<sup>78</sup>) contribute to poor families' food insecurity, which in turn affects dietary intake and nutritional quality for mothers and children.
- 3.16 The country also has high maternal and infant mortality rates. In 2014, 113 deaths were recorded for every 100,000 live births<sup>79</sup> and infant mortality was 28 deaths for every 1,000 live births.<sup>80</sup> These figures are higher than the averages for Latin America and the Caribbean at 85 and 16, respectively,<sup>81</sup> and are worse in the indigenous regions where they reach 163 and 32.<sup>82</sup> For example, the highest maternal mortality rates are found in the departments of Huehuetenango, Totonicapán, and Quiché, with average indigenous populations of 78%.
- 3.17 Disparities in the density of health personnel between urban and rural areas (25.7 health professionals for every 10,000 inhabitants in urban areas compared to only 3.0 for every 10,000 in rural areas) together with the lack of a health care system organized in Integrated Health Services Networks, and the limitations of the hospital network (supply of medications, obsolete infrastructure and equipment, problems in the referral and counterreferral system) contribute to the fact that 25% of the population has no access to health services, and the quality of services is low,<sup>83</sup> with a greater impact on the indigenous population. For example, only 29% of indigenous women receive prenatal services.<sup>84</sup>
- 3.18 Added to these challenges are the institutional limitations of the lead agency. Low levels of budgetary execution,<sup>85</sup> management problems, staff shortages, and limited cultural relevance in the delivery of services characterize the performance of the Ministry of Public Health and Social Welfare (MSPAS), reducing indigenous users' level of trust in public health services.<sup>86</sup> Experiences with discrimination against indigenous peoples in health clinics, the lack of culturally appropriate health services, and ignorance of Mayan languages on the part of health personnel have contributed to this lack of trust.<sup>87</sup> For example, 20% of indigenous women of childbearing age do not speak Spanish, and for those who do speak Spanish it is often their second language. This linguistic barrier is the factor most responsible for

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<sup>78</sup> The situation is worse in the Dry Corridor that covers seven departments. In 2016, the United Nations Food and Agriculture Organization (FAO) estimated that, due to drought, 900,000 people were suffering from food insecurity. FAO. "Dry Corridor Central America, Situation Report," June 2016.

<sup>79</sup> MSPAS, 2015.

<sup>80</sup> ENSMI, 2014-2015.

<sup>81</sup> Pan American Health Organization/World Health Organization, 2014.

<sup>82</sup> National maternal mortality study. SEGEPLAN / MSPAS, 2011.

<sup>83</sup> Sixty percent of maternal deaths are related to aspects of quality, coverage, and efficiency in the health system. Institute of Health Metrics and Evaluation. "Encuesta de Línea de Base. Salud Mesoamérica 2015 Guatemala," 2014.

<sup>84</sup> Chomat, A., *et al.* "Maternal health and health-seeking behaviors among indigenous *Mam* mothers from Quetzaltenango, Guatemala," *Pan American Journal of Public Health*, Vol. 35(2), 2014.

<sup>85</sup> Between 2012 and 2016, the MSPAS executed on average 90.6% of the annual budget allocation. During this period, average budgetary execution in other countries of the region was: Nicaragua: 98.4%, Costa Rica: 97.1%, Honduras: 94.5%, El Salvador: 92.1%, and Panama: 89.9%.

<sup>86</sup> Avila, C., R. Bright, J. Gutiérrez, K. Hoadley, C. Manuel, and N. Romero. "Guatemala Health System Assessment," United States Agency for International Development (USAID), August 2015.

<sup>87</sup> Rohloff, P., A. Diaz, and S. Dasgupta. "Beyond development: A critical appraisal of the emergence of small health care non-governmental organizations in rural Guatemala," *Human Organization*, Vol. 70, 2011.

the low utilization of health services by indigenous women, beyond factors such as education or economic level.<sup>88</sup>

- 3.19 The gap in the poor rural population's access to **water and sanitation** is closely related to health conditions. Low levels of access to water and sanitation services have an impact on high malnutrition rates. According to the MSPAS, of the country's 20 main causes of morbidity, nine are associated with a lack of access to or deficient quality in the delivery of basic water and sanitation services, representing 20.1% of total medical visits. These problems are related to the limited coverage of these services. For example, 36% of the rural population has no connection to drinking water, compared to 11% for the urban population. In the area of sanitation, the urban-rural gap is 28 percentage points, above the average gap for the region (24 percentage points). Although the level of sanitation infrastructure increased in recent years, reaching 58.3% of the population in 2014, the level recorded represents a lag in terms of per capita income. In addition to geographic gaps, there are also differences among population groups. Data from 2014 indicate that only 61.5% of indigenous households in rural areas have a drinking water connection compared to 65.9% for nonindigenous households. A similar situation is recorded for sewer services, which reach only 11.4% of indigenous households in rural areas compared to 19% for nonindigenous households.<sup>89</sup> The sector also has institutional and management problems that impact service efficiency and quality among those populations.<sup>90</sup>
- 3.20 **Access to safe energy**, which includes energy for cooking, impacts human capital accumulation and is essential to improving the population's living conditions.<sup>91</sup> Rural households are highly dependent on firewood as a source of energy for cooking. Nearly 2.1 million households use firewood to cook on inefficient stoves, which are prevalent in areas of the country without electricity among rural, indigenous, and marginal urban populations.<sup>92</sup> The use of firewood affects the environment (CO<sub>2</sub> emissions and deforestation levels), is harmful to health (respiratory diseases in particular), and does more harm to women and children who spend most of their time close to home.<sup>93</sup> In Guatemala, between 5% and 20% of families sleep in the same room where they cook and 70% of households that use firewood to cook do not have a system for extracting the smoke. As a result, in 2010, more than 5,000 deaths due to air pollution problems were recorded, with this being the second leading cause of disability in the country. This indicates that opportunities exist for improving the use of energy for cooking through efficient stoves with technical

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<sup>88</sup> Ishida, K., *et al.* "Ethnic inequality in Guatemalan women's use of modern reproductive health care," *International Perspectives on Sexual and Reproductive Health*, Vol. 38, Number 2, 2012.

<sup>89</sup> ENCOVI, 2014.

<sup>90</sup> There is no legal framework or central agency to regulate, standardize, and coordinate the management of water resources in the country. The delivery of tap water and sanitation services is decentralized to the municipios in urban areas and water boards in rural areas.

<sup>91</sup> National Urban and Rural Development Plan, SEGEPLAN. "Plan Nacional de Desarrollo K'atun: nuestra Guatemala 2032," 2014.

<sup>92</sup> IDB. "Guatemala: Country Development Challenges," 2016.

<sup>93</sup> The association between use of firewood and respiratory diseases is highly significant as households that use firewood have a 31% higher probability of contracting acute or chronic respiratory diseases. SEGEPLAN, 2010.

designs and parameters that make it possible to cook with less energy input and to help reduce pollution levels in the home.

- 3.21 The **educational level** of the population living in poverty is low and is an obstacle to its social and productive development. Notable challenges in the sector include net coverage gaps at the various levels of the educational system,<sup>94</sup> as well as quality issues. In preschool, an important segment for acquiring skills and entering the system better prepared, net coverage has fallen from 58.9% in 2009 to 51.1% in 2014, lower than the average for Latin America and the Caribbean for 2014 (67%)<sup>95</sup> and affecting boys and girls equally.<sup>96</sup> The limited number of school facilities that offer preschool is one of the factors explaining this performance.<sup>97</sup> The net coverage rate at the primary school level also shows setbacks, falling from 97.4% in 2009 to 90.1% in 2015,<sup>98</sup> a situation that is related to the decline in preschool registration, limiting continuity and the student's successful completion of subsequent levels of schooling.<sup>99</sup> Errors in the projected number of school-aged children—due to the migration of children to the United States and the lack of a recent population and housing census (the last one was in 2002)—together with conditions of insecurity and child labor are additional factors that may have an effect on coverage at this level.<sup>100</sup>
- 3.22 There is a notable education gap based on ethnicity; while the secondary school completion rate for the nonindigenous population is 60%, that rate is 37% among the indigenous population. These rates are related to aspects of quality, curricular and cultural relevance, and students' poverty. Thus, 62% of students do not register due to economic reasons, 18% due to lack of interest, and 7% due to chores at home.<sup>101</sup> Dropout at the diversified level is higher among males (6.63%) than females (4.52%), a trend that holds true in the other levels of the educational system.<sup>102</sup>
- 3.23 Added to access and retention problems is the low quality of education throughout the school system. First, despite improvement in its results in the international TERCE<sup>103</sup> test conducted in 2013 in fifteen Latin American and Caribbean countries for students in the third and sixth grades of primary school in the areas of mathematics and language (reading and writing), Guatemala is still below the

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<sup>94</sup> Preschool, primary, basic, and diversified. The first two levels cover six years; basic covers three years, and diversified covers between two and three years, depending on the different areas offered.

<sup>95</sup> UNESCO Institute for Statistics (UIS), 2016.

<sup>96</sup> Girls 51% and boys 51.3%. Ministry of Education (MINEDUC). "Anuario estadístico de la educación," 2015.

<sup>97</sup> There are 5,129 primary schools that do not offer preschool, and there would be demand at these centers if preschool classrooms were added. Bismarck, P. "Educación Pre primaria – Proyecto de Lineamientos de Política Económica, Social y de Seguridad 2011-2021," Centro de Investigaciones Económicas Nacionales, Guatemala, 2015.

<sup>98</sup> Statistics Portal of the Learning Improvement Information Center (CIMA). IDB, Education Division, 2017.

<sup>99</sup> In 2014, coverage at the basic level was 45%, compared to 25% at the diversified level. Idem.

<sup>100</sup> Sanchez, S., K. Scott, H. Lopez. "Systematic Country Diagnostic," World Bank, 2016.

<sup>101</sup> IDB. "Guatemala: Country Development Challenges," 2016.

<sup>102</sup> (i) preschool: 3.2% boys and 2.9% girls; (ii) primary: 3.6% boys and 3.1% girls; and (iii) basic: 7.4% boys and 6.3% girls. MINEDUC, "Anuario estadístico de la educación," 2015.

<sup>103</sup> Third Regional Comparative and Explanatory Study conducted by UNESCO.

regional average in both areas.<sup>104</sup> Results of national tests confirm the existence of low learning levels in primary education. In 2013, only 39.9% and 43.6% of the students in third and sixth grade achieved an adequate level of competence in reading and mathematics, below the rate for Latin America and the Caribbean (52.8% and 53.1%).<sup>105</sup> Second, the lack of a contextualized curriculum and of qualified staff<sup>106</sup> also affect the quality of learning and contribute to high dropout rates.<sup>107</sup> At the secondary level, where specialized teachers are needed in mathematics, science, and foreign language, the number of teachers is inadequate.<sup>108</sup> This situation is aggravated in educational services for indigenous populations as staff do not have teaching skills specific to the cultural characteristics of such populations (e.g., using the indigenous language and Spanish) and the teaching curriculum is not contextualized to the local reality.

- 3.24 In addition, the schools' physical facilities are limited and deteriorated, affecting the learning environment. For example, 36% of Guatemalan students attend primary schools with only one or none of the adequacy criteria in terms of infrastructure, and only 15% of students attend schools with satisfactory levels of learning spaces, placing the country among the worst in the region.<sup>109</sup> These conditions are exacerbated in rural areas and among the indigenous population.
- 3.25 In recent years, Guatemala has used Conditional Cash Transfer (CCT) mechanisms to deliver social services to poor rural populations, given their ability to broaden demand for such services and facilitate the transfer of resources aimed at poverty alleviation.<sup>110</sup> Although these programs suffer from low coverage and limited budgetary appropriations (0.1% of GDP in 2016), they have mechanisms for targeting beneficiaries that are able to direct the investment so as to deliver education and health services to the poorest population (see paragraph 2.6).
- 3.26 The IDB Group will support the country in reducing poverty and inequality by expanding access to basic services for the poor population. Specifically, the Bank has the following objectives: (i) to strengthen the coverage and quality of the integrated health services network to help improve maternal-child health conditions

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<sup>104</sup> In the sixth grade tests, (reading, mathematics, and science) it was in tenth place. In the third grade mathematics tests, it achieved eleventh place. IDB "Education Quality and Coverage Improvement Program (GU-L1087)," 2015.

<sup>105</sup> CIMA. IDB, Education Division, 2017.

<sup>106</sup> Until 2012 Guatemala was one of the few Latin American countries where teachers still had secondary level training requirements. Currently, primary school teachers must have a higher education degree in primary school teaching. In contrast, preschool teachers do not have this requirement.

<sup>107</sup> At age 18, only 20% of the population in the most recent generation is studying or has completed middle school, 30% continue in secondary school, 3% in primary school, and 47% has dropped out of the educational system. "Guatemala: Country Development Challenges," 2016.

<sup>108</sup> Programa de Promoción de la Reforma Educativa en América Latina y El Caribe. "Informe de Seguimiento de Política Docente – Guatemala," 2015.

<sup>109</sup> Adequacy criteria: (i) access to drinking water, sewers, sanitary facilities, and garbage collection; (ii) connection to light and telephone services; (iii) academic spaces; (iv) offices; (v) multiple use spaces; and (vi) classroom equipment. IDB, OREALC/UNESCO. "Sufficiency, equity, and effectiveness of school infrastructure in Latin America according to TERCE," 2017.

<sup>110</sup> Ranganathan, M., M. Lagarde. "Promoting healthy behaviors and improving health outcomes in low and middle-income countries: a review of conditional cash transfer programs," *Preventive Medicine*, vol. 55, 2012.

and reduce levels of chronic malnutrition in children under the age of five;<sup>111</sup> (ii) to improve access to quality education services, through increased coverage of preschool and improved learning levels in primary school; and (iii) to expand access to water and sanitation services through an increase in improved sources for the supply of drinking water and improved sanitation services.<sup>112</sup> These actions will be concentrated in rural and indigenous areas, will include improvements in the technical and management capacities of the respective agencies, and will be implemented primarily through the portfolio in execution.<sup>113</sup> The targeting criteria of the CCT mechanisms will be used to expand the supply of education and health services for vulnerable populations. The actions under this pillar will seek synergies with the territories given priority under the PAPT, devoting more attention to the departments with larger gaps in service. The IIC will support these efforts, looking for opportunities for participation in infrastructure projects, particularly in water and sanitation and health.

- 3.27 The actions under this pillar are aligned with the challenge of social exclusion and inequality of the IDB Update to the Institutional Strategy 2010-2020 and with the objectives of eradicating extreme poverty, strengthening the capacity of the State, and providing inclusive infrastructure and infrastructure services. In addition, an effort will be made to ensure that investments supplement the PAPT, which also puts emphasis on developing human potential to reverse adolescent migration and promote the country's productive development. In addition, the proposed actions are aligned with the IIC Business Plan, which identifies infrastructure improvements,<sup>114</sup> and support two of the priority business areas identified by that plan: the promotion of infrastructure for development; and the provision of basic goods and services by private entities, opportunities for income generation and social mobility for vulnerable populations,<sup>115</sup> offering opportunities for public-private coordination throughout the country strategy.

### **3. Private sector development**

- 3.28 The country's characteristically low tax collection levels have helped to reduce the level of public investment, creating an insufficient environment for increasing growth and closing social gaps. Between 2010 and 2014, average public investment was

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<sup>111</sup> This model proceeds from the community to the hospitals and facilitates the appropriate delivery of cost-effective strategies for reducing malnutrition and improving maternal-child health.

<sup>112</sup> Multisector collaboration will be promoted in health, climate change, and energy with initiatives to improve access to cooking systems. Given that respiratory infections are among the main causes of infant mortality, these actions are expected to help reduce infant mortality levels.

<sup>113</sup> Program to Strengthen the Hospital System (GU-L1009), Improved Access and Quality of Health and Nutrition – Phase I (GU-L1022), Mesoamerican Health Facility 2015 – second operation (GU-G1002), Mi Escuela Progresiva (My School is Making Progress) Program (GU-L1023), Education Quality and Coverage Improvement Program (GU-L1087), and Water and Sanitation Program for Human Development – Phase I (GU-L1039). Synergies will also be sought in the area of rural transportation with the Project to Support the Rural Economic Development Program (GU-L1006), in order to contribute to poor populations' access to basic social services.

<sup>114</sup> The three priority segments identified in the IIC Business Plan are: infrastructure, business sector, and financial markets. Four key priority sectors are identified within the business sector: agroindustry; telecommunications, media, and technology; manufacturing; and tourism.

<sup>115</sup> IIC. "2017-2019 Business Plan," document CII/GA-77-2, 2016.

- 1.9% while the average for Latin America was 6.6%.<sup>116</sup> Along these same lines, private investment has trended downward in recent years, reaching 13.1% of GDP in 2014, compared to an average of 18.5% over the period 2001-2007.<sup>117</sup> This reduction is due in part to conditions of insecurity<sup>118</sup> and the limited provision of basic public goods such as infrastructure and social services.
- 3.29 The factors limiting private sector development as well as private sector access to global markets include the high costs of transportation and logistics. The cost of moving goods over the principal logistics corridors is 17% higher than the average for Central America. This is closely linked to deteriorating conditions on the road network due to the lack of periodic and routine maintenance,<sup>119</sup> insufficient depths in the main export ports, and obsolete equipment and limited cargo handling capacity of the major ports and airports.<sup>120</sup> On this last point, airport infrastructure quality in Guatemala ranks 83rd among 144 countries, below its Central American peers such as Costa Rica (61) and El Salvador (47).<sup>121</sup> Investment in transportation was 1.2% of GDP in 2014 compared to 1.7% of GDP for Latin America and the Caribbean in that same year,<sup>122</sup> a factor that also contributes to the lags.
- 3.30 Road congestion in the cities increases the time needed to move goods by 12%. The routes going through Guatemala City, where 45% of the country's vehicular fleet is concentrated (3.2 million vehicles) and where 4.1 million people reside, show additional delays,<sup>123</sup> affecting both commercial activities and the population's travel time.<sup>124</sup> Deficiencies in infrastructure and equipment, together with inefficient processes, increase costs at border crossings, which in Guatemala amount to 26.4% of the value of the product, far above countries like Panama (15.2%).<sup>125</sup> Telecommunications coverage, costs, and quality, particularly in Internet services, also affect business dynamics. Although the total investment in telecommunications has been higher than the average for Latin America and the Caribbean (0.7% of GDP versus 0.4% in 2014<sup>126</sup>), the cost of mobile Internet is 18% higher than the

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<sup>116</sup> (a) Sanchez, S. K. Scott, H. Lopez. "Systematic Country Diagnostic," World Bank, 2016; (b) IMF, 2017.

<sup>117</sup> IDB. "Guatemala: Country Development Challenges," 2016.

<sup>118</sup> According to the World Economic Forum, in 2016, theft and crime were the greatest obstacles to doing business in the country.

<sup>119</sup> Of the 16,860 kilometers that make up the national road network, maintenance work was done on only 10,000 kilometers in 2016. Of these, 70% were primary and secondary networks, and 30% were rural roads (tertiary network). MINFIN. "Sistema de Contabilidad Integrado. Reporte analítico de ejecución física y financiera," 2016.

<sup>120</sup> IDB. "Plan Nacional de Logística de Cargas," 2016.

<sup>121</sup> World Bank, "Global Competitiveness Index," 2016.

<sup>122</sup> Data on economic infrastructure investment in Latin America and the Caribbean, available at: <http://infralatam.info/>.

<sup>123</sup> Dumitrescu, A., G. Smith, T. Osborne. "Guatemala. Elements of a transport and logistic strategy," World Bank, 2015.

<sup>124</sup> To improve urban mobility, the government is evaluating the implementation, under a public-private mechanism, of a metro rail system that would reduce travel times in Guatemala City, and improve competitiveness and citizens' quality of life.

<sup>125</sup> Duran, J. "Evaluación de los efectos de la aplicación de un Programa Centroamericano de Facilitación del Comercio," ECLAC, 2015.

<sup>126</sup> Data on investment in economic infrastructure in Latin America and the Caribbean, available at: <http://infralatam.info/>.

Central American average,<sup>127</sup> and the price for broadband service is close to the median for the Central American isthmus.<sup>128</sup> The number of Internet users in 2014 reached 23.4 for every 100 inhabitants, a level 32 times higher than in 2000. Despite this increase, the level is less than the average for the Latin American region (49). In the area of data transmission, the country has average access speed of 2,919 kilobits per second (Kbps), lower than the average speed in Central America of 3,445 Kbps,<sup>129</sup> indicating room for improvement in the future.

- 3.31 With regard to the energy sector, although electricity costs have fallen in recent years, Central America continues to be the region with the highest costs on the continent. Data from 2011 show that the average price of energy in the Central American industrial sector was US\$0.17/kWh while the average for Latin America and the Caribbean was US\$0.157/kWh,<sup>130</sup> indicating room for improvement to move the sector forward and benefit industrial development. In addition, fossil fuels' high share in the generation matrix (42% in 2015<sup>131</sup>) represents a risk given fluctuations in international oil prices. The high use of petroleum derived liquid fuels, together with a significant increase in the use of coal, increases CO<sub>2</sub> emissions, contrary to the country's climate change agenda. Actions aimed at promoting renewable energies have helped to diversify the matrix to include renewable sources and 58% of the matrix was derived from such sources in 2015. However, that percentage is less than the Central American average (67%), indicating the need to continue promoting diversification of the matrix through renewable sources and natural gas to reduce price volatility and CO<sub>2</sub> emissions.
- 3.32 The effort to diversify domestic generation should be accompanied by the strengthening of the power transmission system (improvement, replacement, and new works) in order to improve service quality. Notable challenges faced by the transmission system include:<sup>132</sup> low investment equal to 0.55% of GDP in 2014, half the average for Latin America and the Caribbean (1% of GDP);<sup>133</sup> radial design of the electrical grid, making it vulnerable to failures in sources of generation or transmission and subtransmission stations; as well as over-expansion of the distribution networks, which together affect the end user's quality of service. In 2010, the average number of power service interruptions per year for companies in Latin America was 33.6, with an approximate duration of 1.4 hours. Guatemala reports an average of 26.4 interruptions with an approximate duration of 1.1 hours.<sup>134</sup> This phenomenon has a greater impact in rural areas, which in 2014 recorded more than 50 hours without electricity for every six-month period. According to the 2016

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<sup>127</sup> Price to access one GB of mobile Internet. International Telecommunication Union. "Measuring the information society report," 2016.

<sup>128</sup> The base price of a monthly Internet subscription (US\$19.50) is less than the regional median (US\$21.70).

<sup>129</sup> AKAMAI. "State of the Internet," 2016. Available at: <https://www.akamai.com/>.

<sup>130</sup> Gabriel Salazar. "Tarifas eléctricas en América Latina y el Caribe: análisis conceptual y comparativo," based on data from the Latin American Energy Organization, 2013.

<sup>131</sup> MEM. "Matriz de generación 2011-2015," 2016. The percentage corresponds to power generation based on coal and oil. The 2013 average for Latin America and the Caribbean for these same sources was 43%. ECLAC. "Las energías renovables no convencionales en la matriz de generación eléctrica," 2017.

<sup>132</sup> IDB. "Guatemala. Country Development Challenges," 2016.

<sup>133</sup> Data on investment in economic infrastructure in Latin America and the Caribbean, available at: <http://infralataam.info/>.

<sup>134</sup> World Bank, "Enterprise surveys," 2016.

National Transmission Expansion Plan. 1,500 km of transmission lines are needed to reinforce the system and improve the quality of service for the end user, particularly in western and northern Guatemala<sup>135</sup> where poverty rates are higher. The limited availability and reliability of the service translate into fewer productive hours and hours to study or work at home, entailing significant gaps in human capital formation. In addition, these deficiencies are reflected in low rates of productivity in companies, limiting their ability to maximize use of installed capital. Over the long term, this situation of limited access and reliability produces disincentives for investments, reducing job opportunities and income gains.<sup>136</sup>

- 3.33 Development of the sector has also contributed to the country's positioning in the Regional Electricity Market (MER) of the Central American Electric Interconnection System (SIEPAC). Guatemala is the main net exporter of power to Central America (net 490 GWh in 2014)<sup>137</sup> and is a net importer with Mexico, a situation that has created economic benefits for the country (approximately US\$87.7 billion between 2013 and 2015) and helps to reduce wholesale electricity prices on national markets in Central America.<sup>138</sup>
- 3.34 While access to financing is not seen as an active constraint on growth at the aggregate level, the disparities in access among different sized firms do represent a significant obstacle for the country. Although MSMEs represent more than 90% of the country's companies, they face serious problems in access to credit. Only 12% of Guatemalan MSMEs have access to financing<sup>139</sup> and when they do obtain financing, it covers only between 15% and 25% of the total investment, one of the lowest coverages in Latin America.<sup>140</sup> This presents an obstacle to improved productivity in these firms as well as to job creation.<sup>141</sup> The anchor company mechanism linking large companies with MSMEs could address this challenge through direct financing offered by large companies or by strengthening the ability of MSMEs to obtain bank loans through their ties to a large corporation. This approach is particularly relevant for Guatemala, since the proportion of investments

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<sup>135</sup> MEM. "Plan Indicativo de Generación y Transmisión de 2016," 2017.

<sup>136</sup> See: (i) Alby, P., J. Dethier, S. Straub. "Firms Operating under Electricity Constraints in Developing Countries," *World Bank Economic Review*, 2013, vol. 27, issue 1, 109-132; (ii) Allcott, H., A. Collard-Wexler, S. O'Connell. "How Do Electricity Shortages Affect Productivity? Evidence from India," *The American Economic Review*, vol. 106, issue 3, 587-624; (iii) Kitchens, Carl, and Price Fishback. 2015. "Flip the Switch: The Impact of the Rural Electrification Administration 1935-1940," *The Journal of Economic History* 75 (4): 1161-95; (iv) Fisher-Vanden, K., E. Mansur, Q. Wang. "Costly Blackouts? Measuring Productivity and Environmental Effects of Electricity Shortages," *The National Bureau of Economic Research, Working Paper 17741*, 2012.

<sup>137</sup> Nicaragua ranked second in net exports of 27 GWh. Duran, J. "Evaluación de los efectos de la aplicación de un Programa Centroamericano de Facilitación del Comercio," ECLAC, 2015.

<sup>138</sup> According to recent estimates, higher levels of energy integration would permit an average regional reduction of 8.4% in electricity costs. IDB, 2017.

<sup>139</sup> IDB. "Guatemala: Country Development Challenges," 2016.

<sup>140</sup> Sanchez, S., K. Scott, H. Lopez. "Systematic Country Diagnostic," World Bank, 2015.

<sup>141</sup> It is estimated that SMEs employ 79% of workers in the department of Guatemala and 92% in the rest of the country. Idem.

- in small and medium-sized firms financed through supplier credits is greater than in the rest of Latin America.<sup>142</sup>
- 3.35 IDB Group interventions, both in the outstanding portfolio and newly identified projects, will support the implementation of this pillar through: (i) expansion and modernization of logistics infrastructure, including border crossings, roads, urban transportation, ports, airports and logistics facilities, as well as increased Internet services; (ii) generation of renewable energy and gas, by increasing these source's share in the electricity generation matrix, improving the transmission system, and investing in electrical integration; and (iii) improved access to financing for MSMEs, through anchor companies and/or financial institutions. In this latter area, the IIC and the MIF will promote value chains, access to credit, entrepreneurship, and productivity initiatives. The implementation of these interventions could help to reduce poverty among rural families through potential inclusion in new markets. In the area of infrastructure, the creation of public-private partnerships will be explored in projects identified as priorities by the government.<sup>143</sup>
- 3.36 This pillar's activities are aligned with the challenges of social exclusion and inequality; low productivity and innovation levels; and limited economic integration established in the IDB's Update to the Institutional Strategy 2010-2020, and with the objectives of providing inclusive infrastructure and infrastructure services, establishing suitable institutional frameworks, improving regional infrastructure, incorporating companies in value chains, and promoting the alignment of integration policies and instruments. In addition, the areas identified contribute to the strategic priorities of the IIC Business Plan under the pillars of strategic selectivity, systemic approach, and development effectiveness. Moreover, this pillar's activities are covered under the infrastructure and business sector priorities identified in the IIC Business Plan, as well as the following priority business areas appearing in that plan: (i) increasing MSMEs' access to finance and technical assistance; (ii) promoting infrastructure for development; (iii) supporting innovation and technological development; (iv) enhancing private provision of basic goods and services, income generating opportunities, and social mobility for vulnerable populations; and (v) fostering green growth. The actions under this pillar are expected to contribute to the goals indicated in the PAPTN in the area of productivity.
- 3.37 **Crosscutting issues.** The design of justice, health, education, water and sanitation, and energy actions will include more analysis of local sociocultural considerations and social impacts, and the promotion of community participation in programs, particularly in rural and indigenous areas. In addition, factors that help to improve gender equality and promote citizen participation for women will be taken into account, as appropriate.
- 3.38 Climate change impacts the areas of energy, health, and agricultural value chains, so that the initiatives to be implemented, through synergies with the IIC, will include disaster risk management and climate change adaptation and mitigation measures, while technical assistance in these areas will continue to be provided to the country. In addition, IDB Group actions will seek to support the targets established in the

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<sup>142</sup> As of 2010, 13.4% of investments made by small firms and 18.1% of investments made by medium-sized firms were financed by suppliers' credit, compared to 7.4% for small firms and 7.6% for medium-sized firms in the rest of the region. World Bank, World Enterprise Survey, 2017.

<sup>143</sup> For example, the Metro rail system, the Tecún Umán Intermodal Port, and the Northwest Express.

2016 National Climate Change Plan in the areas of: (i) human health, with increased infrastructure for primary and secondary health care in areas vulnerable to climate change; (ii) forest resources, ecosystems, and protected areas, through the National Strategy on Avoided Deforestation and Forest Degradation, and the Forest Investment Program, with priority given to actions in territories relevant to water regulation and forest conservation;<sup>144</sup> (iii) agriculture, livestock, and food security, through increased production of basic grains and traditional crops in the dry corridor and the use of environmentally sustainable agricultural practices and climate-smart technology. In addition, the lessons learned from projects in the Chixoy region will be taken into account, considering their impact on rural development; (iv) integrated management of water resources, giving more people access to drinking water; and (v) energy, through increased renewable energy in the power generation matrix and initiatives for the efficient use of firewood as a source of energy for cooking, making it possible to reduce greenhouse gas emissions from the use of firewood and the health effects thereof, particularly with respect to women and children and indigenous and rural populations.

- 3.39 **Dialogue area.** Guatemala is one of the least urbanized countries in Central America, with approximately half of its population considered urban. However, it is experiencing one of the highest urban growth rates in the region (3.4%). Much of this growth is being absorbed by intermediate cities, creating significant challenges in service delivery but also an opportunity for inclusion through employment.<sup>145</sup> As part of the Emerging and Sustainable Cities initiative,<sup>146</sup> through dialogue and technical assistance, the Bank will address the development challenges of intermediate cities. Considering the impact of rural migration on urban growth, the dialogue activities will focus on the territories given priority in the PAPTN.

#### IV. ESTIMATED LENDING FRAMEWORK

- 4.1 Macroeconomic stability in recent years has afforded the country access to domestic and international markets as well as multilateral financing sources to cover its gross financing requirements of an estimated average of US\$2.031 billion per year for the period 2017-2020. Considering the magnitude of the development challenges given priority during the same period, the country is expected to continue using such mechanisms to cover its financing requirements.
- 4.2 Progress made in executing the portfolio will be the principal element to be taken into account in the programming dialogue on new operations. For this reason, new interventions are not considered in sectors with active operations classified as

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<sup>144</sup> These interventions, as well as the one associated with the efficient use of firewood for cooking cited in point (v), help to meet commitments made to reduce greenhouse gas emissions that Guatemala has prioritized in its Nationally Determined Contribution to the United Nations Framework Convention on Climate Change.

<sup>145</sup> Central America Urbanization Review. "Making Cities Work for Central America," Report ACS18375, The World Bank Group, 2016.

<sup>146</sup> In 2015, as part of this initiative, the "[Diagnóstico de Competitividad y Desarrollo Económico Local de la ciudad de Quetzaltenango](#)" was developed and analyzed the competitiveness of the municipio, identified areas limiting its development, and developed a strategy/action plan to address those challenges.

having problem status according to the IDB Group's portfolio monitoring system<sup>147</sup> unless they have a corrective action plan agreed upon with the government.

- 4.3 In this context, and subject to compliance with the foregoing, the annual average planned approvals and disbursements during the country strategy period are US\$130 million and \$163 million, respectively. Thus, the estimated support for the 2017-2020 period would be US\$521 million in sovereign guaranteed approvals, while disbursements are estimated at US\$650 million. Under these assumptions, at the end of the strategy, the Bank would represent 32% of multilateral debt and 23% of external public debt.

## V. STRATEGY IMPLEMENTATION

- 5.1 **Factors for improving portfolio execution.** The low execution levels that characterize the Bank's portfolio in Guatemala constitute an area of special attention within the country strategy given their ability to affect the implementation of programs agreed upon with the country and achieve the expected outcomes. To improve the pace of performance and the effectiveness of operations, the following measures aligned with the lessons learned identified in Section II and the OVE recommendations will be promoted:
- a. **New operations:** (i) design programs with results delimited by local capacities and context, paying particular attention to local governance and the indigenous peoples' worldview, as applicable; (ii) analyze with the MINFIN the implementation of execution mechanisms to streamline the performance of public investment projects, including the possibility of financing the compensation of public officials who are part of the execution units financed with funds from the Bank's programs, pursuant to national legislation<sup>148</sup> and always in compliance with Bank policy on eligible expenses, so that they have the necessary levels of technical and administrative autonomy to carry out the actions planned, which would reduce staff turnover and help improve the institutional capacities of those units. In addition, it is anticipated that program audits will be performed in accordance with Bank policies, for which training will be provided to officials from the Ministry of Public Finance (MINFIN) and the Office of the Comptroller General (CGC); (iii) support the design and execution of programs with technical cooperation resources; (iv) make explicit reference to the application of IDB procurement policies and the use of standard project management instruments; (v) define the procurement plan and use final specifications to initiate bidding processes; (vi) coordinate with the MINFIN to include multiyear budget appropriations for the Bank's programs within the government's general budget; and (vii) synchronize approvals with the preparation of the government's general budget.
  - b. **Outstanding portfolio:** (i) restrict deadline extensions for the final disbursement only to funds assigned to awarded tenders; (ii) strengthen contractor selection criteria; (iii) improve the quality of preinvestment; (iv) hold

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<sup>147</sup> Progress Monitoring Report.

<sup>148</sup> Article 80 of the Budget Act indicates the possibility of financing the compensation of public officials in program execution units funded with external resources, provided that loan contracts, grant agreements, or decrees approving them explicitly reflect this.

periodic meetings with the MINFIN and CGC to review portfolio progress and agree on actions to streamline execution; (v) include the support of transparency-related civic groups in procurement and accountability processes for Bank programs; (vi) strengthen operations management through increased monitoring of performance of loan contracts and standardization of planning instruments; and (vii) continue to promote synergies between the outstanding portfolio and the territories prioritized by the PAPTN, as well as in the Chixoy region.

- 5.2 **Focus on indigenous peoples.** The persistent access and quality gaps in the provision of basic social services for the Maya, Xinca, and Garífuna peoples require an innovative and comprehensive approach in the territory to allow greater participation by those populations in the definition and modalities of social and infrastructure services. To achieve this, efforts will be made to deepen knowledge of the various worldviews and study aspects of local governance in coordination with budget appropriations at the national level. Both the actions being implemented in the Chixoy region and new initiatives to be promoted will take these inputs, resulting from Bank coordination with the IIC, into account as part of their design.
- 5.3 **Use of country systems.** For the management and supervision of operations, the Bank uses the budget, cash management, accounting, and reporting subsystems of the Integrated Financial Management System, as well as the Government Contracting and Procurement Information System (GUATECOMPRAS) as the mechanism for publication of procurement procedures. During the strategy period, the IDB will continue to work with the government, supporting the strengthening and modernization of the CGC, with a view to reducing disparities with international standards, increasing transparency and operational efficiency, and ensuring that national internal and external audit systems can be used for the supervision and auditing of IDB-financed projects. On a supplementary basis, there are plans to assist the MINFIN in efforts initiated to adopt the International Public Sector Accounting Standards (IPSAS), in implementing reforms of the government contracting law and the general government procurement registry. Similarly, there are plans to move ahead on validating the electronic reverse auction as the country system to be used up to the shopping threshold in executing operations. In addition, support will be given to actions leading to application of the MAPS<sup>149</sup> diagnostic and identifying actions to strengthen and improve the transparency of government procurement in Guatemala.
- 5.4 The following table summarizes the status of country systems in Guatemala and their estimated use during the 2017-2020 strategy period:

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<sup>149</sup> Methodology for Assessing Procurement Systems (MAPS).

**Table 2. Country Systems**

Use of country systems	Baseline 2015 <sup>150</sup>	Estimated use 2020	Actions planned during country strategy
Budget	100%	100%	
Cash management	100%	100%	
Accounting	100%	100%	Support for the government in the process of IPSAS implementation.
Reporting and financial information	100%	100%	
Internal audit	15%	20%	Support for improving supervision and ex post reviews in executing agencies.
External control	15%	20%	Support and assistance to the CCR to strengthen the entity's institutional framework, execution of its strategic plan, and adoption of the International Standards of Supreme Audit Institutions (ISSAI).
Information system	100%	100%	
Shopping	15%	20%	Validation of the electronic reverse auction.
Individual consulting	15%	0%	
Partial NCB	15%	0%	
Advanced NCB	15%	0%	

5.5 **Coordination with other donors.** The Bank will continue dialogue and operational coordination on: (i) Health and nutrition with the Spanish Agency for International Development Cooperation (AECID), the United States Agency for International Development (USAID), the PepsiCo Foundation, the Government of Japan, and the Bill and Melinda Gates and Carlos Slim Foundations in the context of the Mesoamerican Health Initiative; (ii) Water and sanitation, with AECID through the Spanish Cooperation Fund for Water and Sanitation in Latin America and the Caribbean; (iii) Public finances, with the International Monetary Fund (IMF), the World Bank, the German Agency for International Cooperation (GIZ), and U.S. government cooperation agencies (USAID and OTA);<sup>151</sup> (iv) Citizen security, with the European Union (EU); and (v) Climate change with the World Bank, USAID, EU, GIZ, the UNDP, and others. In addition, within the context of the PAPTN, coordination efforts will continue with the U.S. government agencies involved.

## VI. RISKS

6.1 **Political risk.** This risk has two dimensions: first, the high political fragmentation of the National Assembly requires the ruling party to build alliances to approve the programs and reforms supported by the Bank, which could generate delays in the process of legislative ratification of the operations. In addition, high turnover of high-level officials and the recent integrity problems at various levels of the public sector contribute to the slow pace of portfolio execution. To mitigate these risks, the Bank will continue the program communication and dissemination actions with the legislative branch; strengthen coordination at the highest level with the MINFIN and the execution units in order to agree upon and implement portfolio execution

<sup>150</sup> As of 31 December 2015. Reported use in the internal audit, external control, shopping, individual consulting, partial NCB, and advanced NCB systems corresponds to use in PBLs that, given their nature, involve the use of national systems.

<sup>151</sup> Office of Technical Assistance, U.S. Department of the Treasury.

agreements; and continue to closely monitor financial and fiduciary processes related to the Bank's portfolio.

- 6.2 **Execution risks.** The principal factors that could hinder actions to improve portfolio implementation are: (i) *technical factors*: nonperformance of contracts by contractors, low bidder participation in bidding processes, excessive control processes by executing agencies, staff turnover and/or absence and limited technical capacities in execution units; factors that could also slow investment from the private sector windows in the country; and (ii) *political factors*: constant changes in public investment priorities, political influence and integrity problems in bidding processes, and limited budget appropriations. The materialization of such risks, together with possible delays in the implementation of measures to improve the portfolio, could lead to loan cancellations and/or reductions in extensions of timeframes for the final disbursement of loans during the strategy period. To mitigate these risks, the Bank will implement the actions detailed in Section V (paragraph 5.1), which are expected to lead to accelerated execution.
- 6.3 **Risks of natural disasters.** Guatemala is vulnerable to extreme weather and seismic events, the most frequent being the intense rains (floods and landslides) and droughts that have affected the country in recent years.<sup>152</sup> The greatest catastrophic risk of disasters is related to seismic events with expected annual losses of US\$619 million,<sup>153</sup> followed by hurricanes with expected estimated annual losses of US\$393 million.<sup>154</sup> The risk of disasters could cause more intensive harm to populations in marginal urban, rural, and indigenous areas and could impact the country's productive performance. To mitigate these risks, operations will be designed to take into account mitigation measures according to the specifics of each sector, and for portfolio operations, the risks and measures that can be implemented in execution will be analyzed. During the strategy, areas will be identified for cooperation with other donors to maximize resources and coordinate actions in the sector.

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<sup>152</sup> During the period 1998-2014, eight hydrometeorological events associated with climate change were recorded. These represented cumulative damages and losses exceeding US\$3.5 billion, primarily affecting infrastructure, agriculture, and health. Ministry of the Environment and Natural Resources, 2015.

<sup>153</sup> Evaluación de Riesgos Naturales – América Latina. "Perfil de Riesgo Catastrófico de Guatemala," IDB, 2010.

<sup>154</sup> IDB. "Estimación de la amenaza y el riesgo probabilista por huracán en Guatemala, Incorporando el impacto asociado al cambio climático," IDB Technical Note TN-667, 2014.



### ANNEX I: INDICATIVE RESULTS MATRIX

Government Priority	Priority Area	Strategic Objective	Expected Outcomes	Indicators	Baseline, Source, and Year
Transparency	Public management and transparency	Strengthening public finances	Increasing tax revenues	Net tax revenues over nominal GDP	10.2%, MINFIN, 2015
		Strengthen the institutional framework to combat money laundering and corruption	Reducing the country's vulnerability to money laundering, terrorism financing, and corruption	Money Laundering Index of Guatemala <sup>155</sup>	5.78 points, Basel Institute on Governance, 2015
		Strengthen the Public Prosecutor's Office	Reduce impunity	Cumulative impunity in the justice system <sup>156</sup> Rate of cases of violent crimes against women resulting in motions for indictment <sup>157</sup>	99%, CICIG, 2014. 4.4%, Public Prosecutor's Office, 2015
Health and Education	Reducing poverty and inequality	Strengthen the coverage and quality of the integrated health services network	Improve maternal-child health	Life expectancy at birth (women)	76.1 years, UNDP, 2015
				Skilled care during childbirth (%)	66.5%, ENSMI, 2014-2015
				Maternal mortality rate	113 deaths per 100,000 live births, MSPAS, 2015
				Infant mortality rate	28 deaths per 1,000 live births, ENSMI, 2014-2015
				Percentage of children under age two with complete vaccinations	59%, ENSMI, 2014-2015
		Reduction of levels of chronic malnutrition in children under age five	Prevalence of chronic malnutrition in children under age five	46.5%, ENSMI, 2014-2015	
		Improve access to quality education services	Increase in preschool coverage levels	Net coverage rate in preschool (children aged 5 and 6)	45.6%, MINEDUC, 2013
			Improved primary school learning levels	Rate of students with satisfactory or excellent results on national reading tests residing in the country's poorest departments <sup>158</sup>	33.8%, MINEDUC, 2014
		Expand access to water and sanitation services	Increase access to improved sources of drinking water supply and improved sanitation services	Percentage of households with access to improved sources of drinking water	77.8%, ENCOVI, 2014
				Percentage of households in rural areas with access to improved sources of drinking water <sup>159</sup>	64.4%, ENCOVI, 2014
Percentage of households with access to improved sanitation services	58.3%, ENCOVI, 2014				
Percentage of households in rural areas with access to improved sanitation services	28.9%, ENCOVI, 2014				

<sup>155</sup> The index indicates the level of risk and vulnerabilities to money laundering and terrorism financing. Basel Institute on Governance.

<sup>156</sup> Understood as the failure to report, investigate, arrest, prosecute, and provide positive solutions for the victims and/or conviction of those guilty of crimes defined Guatemalan legislation. CICIG. "Sistema de Medición de la Impunidad en Guatemala," 2015.

<sup>157</sup> This indicator will be measured based on actions implemented in the District Prosecutor's Office of Jalapa as part of the Office of the Public Prosecutor Strengthening and Modernization Program (GU-L1095).

<sup>158</sup> Corresponds to average of departments: Alta Verapaz, Totonicapán, Sololá, Quiché, and Huehuetenango.

<sup>159</sup> The Bank's actions in the area of access to improved drinking water and sanitation planned for rural areas will help to reduce coverage gaps in poor and indigenous populations.

Government Priority	Priority Area	Strategic Objective	Expected Outcomes	Indicators	Baseline, Source, and Year
Economic development	Private sector development	Expand and modernize logistics infrastructure	Improve the country's logistics performance	Guatemala's Logistics Performance Index (ranking, #) <sup>160</sup>	111 (2016), World Bank
		Promote the generation of renewable energy and gas	Increase share of renewable sources and gas in the power generation matrix	Share of renewable sources and gas in the power generation matrix	Renewable sources: 58% (2016), MEM Gas: 0% (2016), MEM
		Facilitate SME access to financing	Increase MSME access to financing	Percentage of SMEs that use banks <sup>161</sup> to finance investments	Small: 17.4% Medium-sized: 27.1% (2010), World Bank

<sup>160</sup> The general score the Logistics Performance Index (LPI) reflects perceptions of a country's logistics based on the efficiency of the customs clearance process, the quality of infrastructure related to trade and transportation, the ease of agreeing on shipments at competitive prices, the quality of logistics services, the ability to monitor and track shipments, and the frequency with which shipments reach the consignee at the scheduled time. The index ranges from 1 to 5, where the highest ranking represents the best performance. The LPI is an indicator of perception based on surveys of logistics sector professionals. World Bank, 2015.

<sup>161</sup> Understood as the use of private or state banks to finance asset acquisition in the referenced year. World Bank, "Enterprise surveys indicator descriptions," 2016.

### MATRIX OF COUNTRY SYSTEMS

Strategic Objectives of the IDB Group	Expected outcomes during country strategy	Indicator	Baseline 2015	Indicative targets	Frequency
Strengthen and increase the use of country fiduciary systems	Progress in implementing the IPSAS	% progress on implementation plan for adoption of IPSAS developed and being executed	Legal mandate for adopting IPSAS	25%	At the end of the country strategy period
	Strengthening of internal audit management	% of projects with ex post supervision and review conducted by internal auditors	0%	20%	At the end of the country strategy period
	CGC strengthened and acting in accordance with international standards	% implementation of government audit standards, in harmony with the ISSAI	SAI-PMF 2015 Strategic Plan 2016-2018	100%	At the end of the country strategy period
	Definition of priority business areas based on diagnostic of the national public procurement system using the OECD/DAC methodology	Diagnostic of the system and subsequent action plan	OECD/DAC 2010 diagnostic	Diagnostic performed	At the end of the country strategy period
	Electronic reverse auction validated as a country system, up to the shopping threshold	Electronic reverse auction approved by the Bank's Board of Executive Directors	Electronic reverse auction regulated in the Government Procurement Law	Method validated	At the end of the country strategy period



## ANNEX II: MAIN ECONOMIC AND SOCIAL INDICATORS

	2010	2011	2012	2013	2014	2015	2016
<b>Social indicators</b>							
Population (millions)	14.4	14.7	15.1	15.5	15.9	16.3	16.7
Poverty rate (%)	n.a.	53.7	n.a.	n.a.	59.3	n.a.	n.a.
Extreme poverty rate (%)	n.a.	13.3	n.a.	n.a.	15.3	n.a.	n.a.
Unemployment rate (%)	3.7	4.1	2.9	3.0	2.9	2.7	2.4
Per capita GDP (US\$, PPP)	6,532.8	6,798.8	6,981.5	7,206.7	7,476.1	7,706.7	n.a.
Nominal GDP (millions of US\$)	41,330.2	47,628.2	50,384.9	53,837.5	58,701.5	63,760.6	68,743.7
Nominal GDP per capita (US\$)	2,877.8	3,237.0	3,342.6	3,487.2	3,713.7	3,941.6	4,154.2
<b>Real sector (<math>\Delta\%</math>)</b>							
Nominal GDP US\$	9.6	15.3	5.7	6.8	9.1	8.6	7.8
Real GDP	2.9	4.2	3.0	3.7	4.2	4.1	3.1
Consumption	3.9	3.7	3.4	3.9	4.1	5.1	3.5
Private	3.4	3.6	3.1	3.7	3.9	5.8	4.2
Government	7.8	4.1	5.8	5.6	5.9	-0.1	-2.4
Per capita nominal GDP US\$	7.0	12.5	3.2	4.3	6.5	6.1	5.4
Per capita GDP	0.4	1.6	0.5	1.2	1.8	1.8	0.75
Consumer price index	5.4	6.2	3.4	4.4	2.9	3.1	4.2
<b>Public finances (% of GDP)</b>							
Budget revenues	11.2	11.6	11.6	11.6	11.5	10.8	11.0
Tax	10.4	10.9	10.8	11.0	10.8	10.2	10.4
Nontax	0.8	0.8	0.8	0.7	0.7	0.6	0.6
Budgetary expenditure	14.5	14.4	14.0	13.8	13.4	12.3	12.1
Primary current	8.9	9.0	9.2	9.2	9.0	8.5	8.5
Capital	4.1	4.0	3.3	3.0	2.9	2.2	2.1
Interest	1.5	1.5	1.5	1.6	1.4	1.6	1.5
Primary balance	-1.8	-1.3	-0.9	-0.6	-0.4	0.1	0.4
Overall balance	-3.3	-2.8	-2.4	-2.1	-1.9	-1.4	-1.1
Gross financing requirements	4.4	4.4	3.6	2.8	3.1	2.8	2.6
Public debt	24.4	23.9	24.6	24.8	24.4	24.3	24.0
<b>External sector (% of GDP)</b>							
Current account	-1.4	-3.4	-2.6	-2.5	-2.1	-0.3	-0.5
Trade balance	-10.3	-10.4	-11.4	-11.5	-10.3	-8.7	-8.6
Revenue balance	-2.9	-3.5	-2.6	-2.2	-2.6	-2.5	-2.8
Net transfers	12.0	10.8	11.2	11.4	11.0	11.1	11.1
Financial account	4.4	6.5	4.5	4.9	3.1	1.7	1.1
Direct investment	2.0	2.2	2.4	2.3	2.2	1.7	1.8
Portfolio	0.0	-0.1	0.0	1.0	1.4	-0.1	-0.1
International reserves (US\$ millions)**	5,442	5,737	6,197	6,433	6,587	7,077	7,498

\* Central government, \*\* Excludes Central Bank foreign currency liabilities with the financial system.

Sources: International Monetary Fund, Ministry of Public Finances, Bank of Guatemala, and National Statistics Institute.



### ANNEX III: ESTIMATED LENDING FRAMEWORK

**Lending scenario:** The expected annual average during the country strategy period is US\$130 million in approvals and US\$163 million in disbursements. At the end of the country strategy period, the Bank would represent 32% of multilateral debt and 23% of external public debt. The approval of new investment operations within the country strategy framework will be subject to improvement in portfolio execution levels. In that sense, the sectors where new investment operations are programmed should not have active operations classified as being in problem status, according to the IDB Group's portfolio monitoring system, unless they have a corrective action plan agreed upon with the government.

#### Sovereign Debt Lending Scenario 2012-2020 (US\$ Millions)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total 2017-2020
Approvals <sup>1/</sup>	237.2	-	305.0	150.0	310.0	60.0	270.8	95.2	95.2	521.2
Disbursements	134.7	311.9	80.5	296.8	32.1	189.9	201.0	221.5	38.1	650.5
Repayments	89.8	115.2	130.2	147.2	144.3	165.0	162.0	169.8	180.4	677.2
New loan flow	44.9	196.7	(49.7)	149.6	(112.2)	24.8	39.0	51.8	(142.2)	(26.7)
Subscriptions	6.3	2.0	2.0	2.0	-	-	-	-	-	-
Net capital flow	38.6	194.7	(51.7)	147.7	(112.2)	24.8	39.0	51.8	(142.2)	(26.7)
Interest and fees	72.2	79.6	78.5	76.3	93.6	88.4	82.1	75.7	69.2	315.4
Net cash flow	(33.6)	115.1	(130.2)	71.4	(205.8)	(63.6)	(43.1)	(23.9)	(211.4)	(342.0)
IDB debt	2,216.8	2,414.7	2,356.5	2,500.6	2,388.3	2,413.2	2,452.1	2,503.9	2,361.7	
IDB debt/GDP (%)	4.4	4.5	4.0	3.9	3.5	3.3	3.2	3.1	2.7	
IDB debt/External public debt (%)	35.2	34.2	33.5	33.4	29.2	27.9	27.1	25.9	22.8	
IDB debt/multilateral external debt (%)	47.6	48.1	47.9	46.7	40.8	39.3	38.2	36.3	32.1	

1/ Amounts subject to availability of Bank financial capital.



## ANNEX IV: DEVELOPMENT EFFECTIVENESS MATRIX

COUNTRY STRATEGY: DEVELOPMENT EFFECTIVENESS MATRIX	
<p>In August 2008, the Board of Executive Directors approved the Development Effectiveness Framework (document GN-2489) to increase the evaluability of all Bank development products. The Development Effectiveness Matrix for Country Strategies (DEM-CS) is a checklist of the elements that are necessary to evaluate a country strategy. It is based on the evaluation criteria developed by the Evaluation Cooperation Group of the Multilateral Development Banks in the “Good Practice Standards for Country Strategy and Program Evaluation.”</p>	
<p><b>COUNTRY STRATEGY: GUATEMALA</b></p> <p><b>STRATEGIC ALIGNMENT</b> <i>Refers to the degree to which the design and objectives of the CS are consistent with the country development challenges and with the government’s development plans and priorities.</i></p> <p><b>EFFECTIVENESS</b> <i>This measures whether the country strategy is likely to achieve its intended objectives, through an examination of three dimensions: (i) the quality of the diagnostics on which Bank action is based in each area of work; (ii) the quality of the results matrix for the strategy; (iii) the use and build up of country systems.</i></p>	
<b>Effectiveness dimensions</b>	
<b>I. Country Diagnosis - Country Development Challenges (CDC)*</b>	Yes/No
- The CDC is comprehensive / holistic / complete	Yes
- The CDC clearly identifies the main development challenges	Yes
- The CDC presents magnitudes of the main development challenges that are based on empirical evidence	Yes
<b>II. Priority Areas Diagnostics</b>	%
- That clearly identify and dimension, based on empirical evidence, the <b>priority area’s</b> specific constraints and challenges	100%
- That clearly identify and dimension, based on empirical evidence, the <b>main factors</b> or causes contributing to the specific constraints and challenges	88%
- That provide corresponding <b>policy recommendations</b>	88%
<b>III. Results matrix**</b>	%
- The strategic objectives are clearly defined	100%
- The expected outcomes are clearly defined	100%
- The strategic objectives and expected results that are directly related to the main constraints identified in the Diagnosis	100%
- The indicators are outcome indicators and are SMART	100%
- The indicators have baselines	100%
<b>IV. Vertical logic</b>	Yes/No
- The CS has vertical logic	Yes
* This analysis includes any potential diagnostic document used elaborated to inform.	
** The Results Matrix is composed by indicators that are meaningful to, and capture progress towards, the expected results. The expect results stem from the strategic objectives.	

**CS Diagnostic:**

As part of the Country Strategy 2017-2020 a country development challenges diagnostic was presented, under the title "Guatemala: Country Development Challenges." The CS diagnostic is comprehensive and based on empirical evidence. Based on this diagnostic and the country dialogue process, the country strategy will focus on three development challenges: (i) Improving governance and transparency; (ii) Reduction of poverty and inequality; (iii) Private sector development.

-The diagnostic clearly identifies and dimensions, based on empirical evidence, 100% priority area's specific constraints and challenges.

-The diagnostic clearly identifies and dimensions, based on empirical evidence, the main factors or causes contributing to the specific constraints and challenges for 88% of the priority areas.

-The diagnostic provides corresponding policy recommendations for Bank actions, which are based on empirical evidence, for 88% of the priority areas.

**Results matrix:** Results matrix: The section of the Results Matrix corresponding to the new strategic area includes 9 strategic objectives for Bank action, 11 expected results and 19 indicators to measure progress.

- % 100 of the strategic objectives are clearly defined.

- % 100 of the expected outcomes are clearly defined.

- % 100 CS Objectives are directly related to the main constraints identified in the Diagnosis.

- % 100 of the indicators used are SMART.

- % 100 of the indicators have baselines.

**Country Systems:** During the new CS period, the IDBG will continue the dialogue and technical support to the government, promoting the strengthening and modernization of CGC, with the objective to: achieve international standards; improve transparency and operational efficiency; promotion of the use of internal and external procurement systems as supervision and audit tools for the IDB projects. Complementary, the IDB will assist MINFIN to adopt: the IPSAS; the implementation of the new procurement law; and the reverse electronic auction mechanism. In addition, IDB will support to apply the MAPS diagnosis, and identify actions to strengthen and improve the transparency of public procurement in Guatemala.

**Vertical logic.** The CS has vertical logic.

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

The Strategy identifies four risks: (i) portfolio execution; (ii) politics; and (iii) natural disasters. Mitigation and monitoring measures have been identified for all the risks.

**ANNEX V. MANAGEMENT’S RESPONSES TO THE COUNTRY PROGRAM EVALUATION:  
GUATEMALA 2012-2016 (DOCUMENT RE-503-1)<sup>162</sup>**

OVE’s Recommendations	Management’s response
<p><b>Recommendation 1</b> <b>In dialogue with the government and financial support, prioritize the structural problems of governance that limit the State’s effectiveness.</b> In particular, the State’s ability to address the country’s major challenges, including the delivery of basic services to a substantial share of the population, is limited by the low capacity for revenue collection, weak public expenditure efficiency and effectiveness, and problems of transparency.</p>	<p><b>Partially agree</b></p> <p>The studies done by the Bank as part of preparation of the country strategy 2017-2020 highlight the importance of strengthening certain aspects of governance such as tax revenue intake, effectiveness of public expenditure, and transparency in public management, to enhance equity and growth. Nevertheless, these diagnostic assessments also reveal the need to improve quality and expand access to basic services in nutrition, health, and education, especially for the poor population, given the magnitude of the existing shortfalls in Guatemala, as seen in the chronic malnutrition, maternal and infant mortality, and other indicators.</p> <p>For this reason, Management regards advancing both of these issues in strategic dialogue and financial support to the country as a priority, since the priority issues in the country strategies and financial support reflect a mutual agreement with the governments.</p>
<p><b>Recommendation 2</b> <b>Restructure and reduce the size of the current portfolio.</b> OVE reiterates the recommendation from the previous CPE, to adjust the size of the portfolio to the country’s institutional capacity. In dialogue with the government, operations with significant problems, high transaction costs for the Bank and the country, and those regarded as nonpriority should be canceled. The Bank should also limit extensions to its operations, particularly by not extending projects that have made little progress, and should set specific criteria for the maximum number and time for extensions of the current portfolio.</p>	<p><b>Agree</b></p> <p>In response to the recommendation from the previous CPE, the Bank pursued actions in 2012-2016, in coordination with the government, to adjust the size of the portfolio to the institutional capacity of the country, such as the following: (i) a total of US\$35.6 million in operations with performance problems were canceled; (ii) US\$13.5 million was redirected to the transportation sector for road improvements in the Chixoy region; (iii) resources were redirected from the active portfolio to deal with the 2012 earthquake damage; (iv) the pace of approval of investment loans slowed from a total of eight operations in 2008-2011 to three in 2012-2015; and (v) support was provided to strengthen portfolio management and supervision.</p> <p>In addition, an agenda was implemented to strengthen the institutional capacity of local counterparts in the areas of financial and fiduciary management, contract procurement, planning, and program monitoring. Nevertheless, as OVE notes in the document, the complex institutional and political context during the evaluation period affected the execution of Bank operations in particular, and public investment in general.</p> <p>During the next strategy, the IDB Group, in coordination with the country, will continue to closely track portfolio execution and evaluate what actions are most likely to contribute to improve its performance. Before resorting to cancellation or rejection of an extension, in coordination with the government counterparts, the Bank should also look at the impact of projects in execution on investment levels, especially in priority sectors where the IDB is well positioned and can contribute to results.</p>

<sup>162</sup> The Bank’s Board of Executive Directors asked Management to implement recommendations 1, 2, 3(b), 5, and 6.

OVE's Recommendations	Management's response
<p><b>Recommendation 3</b></p> <p><b>Reorient the use of lending instruments toward achieving results.</b> Given the substantial structural problems in implementation and limited progress in operations, the Bank should explore new results-based mechanisms focused on the implementation of reforms and measures begun with Bank support. The Bank should also play an important role supporting the implementation of these measures and achievement of results, so that they have a more lasting impact.</p> <p><b>(a) Structure the final tranches of PBLs with policy conditions (in the policy matrix) focused on achieving results (rather than actions focused on processes or policies) that encourage the implementation of reforms and measures begun in the early tranches of the PBLs.</b></p> <p><b>(b) Explore within the Bank the possibility of piloting new results-based approaches or instruments.</b></p>	<p><b>Partially agree</b></p> <p>Although Management agrees on the exploration of new results-based mechanisms, some clarification should be introduced as to the scope and effectiveness of certain aspects of the recommendation.</p> <p>(a) The design of policy-based loans (PBLs) is based on the recommendations and criteria stipulated in the Guidelines for Preparation and Implementation of Policy-based Loans (document CS-3633-1). Accordingly, each tranche, even the last ones in the series, may have agreements that vary in scope, including both processes/policies and measures to implement the reforms launched under the program. The Bank's support to the country will continue to be guided by these policies.</p> <p>To support the sustainability of measures envisaged under PBLs, the Bank will continue to pursue technical dialogue with the country in the reform sectors and weigh the possibility of supporting implementation through new interventions such as investment loans and/or technical cooperation operations.</p> <p>(b) As far as the use of new results-based approaches or instruments, programs such as the Mesoamerican Health Initiative (GU-L1001 and GU-G1002) have been under way in Guatemala since 2013, yielding important lessons learned on the use of the results-based modality there.</p> <p>It is also important to acknowledge that the institutional, legal/regulatory, and economic constraints on execution described by OVE throughout its analysis could also jeopardize the effectiveness of the results-based instrument and others.</p> <p>Additionally, Management is in discussions with the Board of Executive Directors for the introduction of a new "results-based loan" modality. If approved, this modality could be considered for Guatemala, especially once its effectiveness has been determined under the Mesoamerican Health Initiative.</p>
<p><b>Recommendation 4</b></p> <p><b>Only approve operations with simple designs and more thorough analyses, to help minimize design problems in the current portfolio.</b> If the Bank decides to approve new investment operations, the designs should involve no more than one executing agency, a small number of components with clearly defined outputs and technical specifications. The Bank should also deepen its analysis of both institutional capacities for project management and the legal and technical viability of its operations, including certainty that suitable land is available in the case of infrastructure projects. Additionally, the Bank, in dialogue with the government, should incorporate conditions to ensure greater stability of executing agency staff.</p>	<p><b>Partially agree</b></p> <p>The 2017-2020 strategy, now in preparation, will put special emphasis on the need to design and implement new execution mechanisms for Guatemala jointly with the authorities, identifying success stories in other countries and with other donors that can be replicated in the specific context of Guatemala.</p> <p>We understand the spirit of the recommendation to only approve operations with simple designs, but think it should be noted that a project design reflects the nature of the development problem to be addressed and is the result of a mutual agreement with the government, so the IDB cannot commit unilaterally to a predetermined approach.</p>

OVE's Recommendations	Management's response
<p><b>Recommendation 5</b>  <b>Use technical cooperation principally to support the preparation and execution of loan operations.</b>            Given the significant implementation problems experienced, approval of technical cooperation operations to support loans should be the priority. If technical cooperation operations are approved to support other priority initiatives of the government and the Bank, these approvals should be more limited and contained, and directly linked to the established strategic objectives and lines of support.</p>	<p><b>Agree</b>            Management agrees with OVE on the importance of utilizing more technical cooperation funding in the design and execution of investment programs. Nevertheless, it sees client support operations as also playing an important role as inputs for the country dialogue, proposing alternative execution mechanisms, and identifying new areas of support. Operations of this kind should therefore remain an important part of the Bank's programmatic offerings.            The request to link technical cooperation operations directly to strategic objectives represents a practice that the Bank has followed regularly, and will continue to do so. Thus, in the period 2012-2016, 75% of technical cooperation operations approved were aligned with the major focus areas, dialogue areas, and crosscutting issues of the country strategy, contrary to OVE's remark in the document that such resources were used in a scattered and opportunistic manner (see paragraph 3.7).</p>
<p><b>Recommendation 6</b>  <b>Redefine the IDB Group's strategy for private sector support in the country to focus on the main constraints to private sector developments, as identified through a specific diagnostic assessment for the country.</b> In the event that SME access to finance is identified as one of these priority constraints, the IDB Group should restructure its current strategy of support through financial intermediaries to target the segments most in need and promote greater competition in the financial system through a better balance of intermediaries supported.</p>	<p><b>Partially agree</b>            There was close coordination among the Bank, the IIC, and the MIF during formulation of the country strategy for 2017-2020, in order to have a specific diagnostic assessment of the country needs and context.            Additionally, the IIC is developing a number of different initiatives to enhance development impact, including a new strategy for small and medium-sized enterprises (SMEs) and support through financial intermediaries.            However, Management believes that the outcomes related to SME financing are not directly related to the level of financial market competition in Guatemala, measured by the size of the financial intermediaries supported,<sup>163</sup> but to the absence of specific targets in terms of the relevant portfolio.            Accordingly, in keeping with OVE's recommendations in its Evaluation of the IDB Group's Work through Financial Intermediaries (document RE-486-2), all IIC operations with financial intermediaries now include specific targets with respect to the relevant portfolio, and, in the specific case of SME financing, with respect to the SME portfolio.</p>

<sup>163</sup> The literature is inconclusive as to the impact of concentration on the financial market and access to finance. (See, for example, Love and Martinez Peria, 2014, "How Bank Competition Affects Firms' Access to Finance," The World Bank Economic Review, and the documents cited in that article.)