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CONFIDENTIAL

August 4, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Guatemala - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a paper on a request from Guatemala for a stand-by arrangement equivalent to SDR 114.75 million. Draft decisions appear on page 20.

This subject has been tentatively scheduled for discussion on Wednesday, August 31, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Elson (ext. 74328) or Mr. Cha (ext. 73811).

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

GUATEMALA

# Request for Stand-By Arrangement

Prepared by the Western Hemisphere Department

(In consultation with the Exchange and Trade Relations Department, the Fiscal Affairs Department, the Legal Department, and the Treasurer's Department)

Approved by Eduardo Wiesner and Manuel Guitian

August 3, 1983

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## I. Introduction

In the attached letter dated August 3, 1983, the Minister of Public Finance of Guatemala and the President of the Bank of Guatemala request a stand-by arrangement for the period through December 31, 1984 in an amount equivalent to SDR 114.75 million (150 per cent of Guatemala's quota). The arrangement would be financed from ordinary (SDR 47.8 million) and enlarged access resources (SDR 66.9 million).

Purchases under the requested stand-by arrangement would not exceed the equivalent of SDR 12.75 million until October 14, 1983; the equivalent of SDR 25.5 million until December 30, 1983; the equivalent of SDR 38.25 million until March 30, 1984; the equivalent of SDR 57.375 million until June 29, 1984; the equivalent of SDR 76.5 million until September 28, 1984; and the equivalent of SDR 95.625 million until December 28, 1984. A waiver of the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement is being proposed. The Fund's holdings of quetzales as of June 30, 1983 stood at 225 per cent of Guatemala's quota of SDR 76.5 million; 100 per cent of these holdings represent a purchase under the compensatory financing facility; and 25 per cent represent a purchase in the first credit tranche. Full utilization of the requested stand-by arrangement would raise the Fund's holdings of quetzales to 375 per cent of quota (275 per cent of quota under the tranche policies) (Table 1).

Guatemala had a stand-by arrangement in the first credit tranche, the first since 1972-73, which expired in November 1982. The 1983 Article IV consultation was conducted in Guatemala City in February-March 1983 and was concluded by the Executive Board on June 1, 1983 (EBM/83/77).

1/ A staff team consisting of R. A. Elson (Head), C. de Rosa (both WHD), P. S. Griffith (FAD), S. Lurie (STAT), G. Oliveros (EP-WHD), and A. Stevens (Secretary-WHD) visited Guatemala City during the period June 2-18, 1983 to hold the discussions which provided the basis for this paper.

Table 1. Guatamala: Projection of the IMF Position

| | Outstanding as of June 30 1983 | 1983 Aug. | 1983 Sept.-Oct. | 1983 Nov.-Dec. | 1984 Jan.-Mar. | 1984 Apr.-Jun. | 1984 Jul.-Sept. | 1984 Oct.-Dec. | Outstanding as of Dec. 31 1984 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | (In millions of SDRs) | | | | | |
| Purchases 1/ | 95.600 | 12.750 | 12.750 | 12.750 | 19.125 | 19.125 | 19.125 | 19.125 | 210.350 |
| Credit tranches | 19.100 | 12.750 | 12.750 | 12.750 | 19.125 | 19.125 | 19.125 | 19.125 | 133.850 |
| Ordinary resources | (19.100) | (1.463) | (5.795) | (5.795) | (8.693) | (8.693) | (8.693) | (8.694) | (66.926) |
| Borrowed resources | (--) | (11.287) | (6.955) | (6.955) | (10.432) | (10.432) | (10.432) | (10.431) | (66.924) |
| Compensatory financing | 76.500 | -- | -- | -- | -- | -- | -- | -- | 76.500 |
| Repurchases | | -- | -- | -- | -- | -- | -- | -- | |
| Fund's total holdings of quetzales (end of period) | 172.100 | 184.850 | 197.600 | 210.350 | 229.475 | 248.600 | 267.725 | 286.850 | 286.850 |
| Excluding compensatory financing facility | 95.600 | 108.350 | 121.100 | 133.850 | 152.975 | 172.100 | 191.225 | 210.350 | 210.350 |
| | | | | (In per cent of quota) | | | | | |
| Fund's total holdings of quetzales (end of period) | 225.0 | 241.6 | 258.3 | 275.0 | 300.0 | 325.0 | 350.0 | 375.0 | 375.0 |
| Excluding compensatory financing facility | 125.0 | 141.6 | 158.3 | 175.0 | 200.0 | 225.0 | 250.0 | 275.0 | 275.0 |

Source: Fund staff projections.

1/ Subject to repurchases.

This report is organized as follows: a brief summary of recent developments is given in Section II which is followed by a discussion of the Guatemalan Government's economic program for 1983-84 as described in the attached letter of intent (Section III); the medium-term outlook is presented in Section IV, the staff appraisal in Section V, and proposed decisions in Section VI. The report also includes six appendices covering the main features of the Government's tax reform (Appendix I), Fund relations with Guatemala (Appendix II), financial relations with the World Bank Group (Appendix III), principal assumptions and main elements of the financial program (Appendix IV), selected economic and financial indicators (Appendix V), and a chart on exchange rate indices (Appendix VI). The proposed stand-by arrangement is included as Attachment I and the letter of intent is included as Attachment II.

## II. Summary of Recent Developments 1/

Since mid-1979 the economic and financial position of Guatemala has deteriorated because of a combination of external and internal factors. Political developments in the Central American region have eroded private sector confidence with adverse effects on investment, trade, and domestic financial savings. At the same time, the external terms of trade deteriorated sharply as a result of the second oil price shock and declines in the prices of Guatemala's major exports.

The negative impact of these external forces on the Guatemalan economy was compounded by expansionary fiscal and monetary policies. During 1980 and 1981, the overall deficit of the Central Government rose to 4-1/2 per cent and 7-1/2 per cent of GDP, respectively, compared with an average of 1 per cent in 1977-78. This deterioration reflected, on the one hand, a weakening in tax administration and in yields from foreign trade taxes and, on the other hand, a rapid expansion in development expenditures. Most of the increment in the overall government deficit was financed by increased borrowing from the Bank of Guatemala. In addition, the net domestic assets of the Bank of Guatemala expanded rapidly because of an increase in rediscounts to the banks and a reduction in legal reserve requirements designed to support a high rate of credit expansion to the private sector at a time when the banks were experiencing a decline in the rate of their deposit growth. As a result of the foreign and domestic factors just discussed, the net international reserves of the Bank of Guatemala declined by more than US$300 million in both 1980 and 1981. At the same time the rate of growth in real GDP decelerated from around 5 per cent in 1978-79 to less than 1 per cent in 1981.

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1/ Recent economic developments in Guatemala and performance under the recent stand-by arrangement were reviewed in detail in the staff reports for the 1983 Article IV consultation (SM/83/76 and SM/83/79).

To check the deterioration in Guatemala's financial performance, the authorities framed an adjustment program for 1982 which was supported by the one-year stand-by arrangement mentioned above. The main objective of the program was to limit the loss in net official international reserves to no more than US$50 million. This objective was to be achieved by restrained monetary and fiscal policies, accompanied by an increase in domestic interest rates. The results achieved by the program were mixed, in part because some of the main assumptions of the program did not materialize. Contrary to expectations, exports fell in 1982 for the second consecutive year, and real economic activity declined by an estimated 3-1/2 per cent, instead of a projected growth of 2-1/2 per cent.

The weakness of the domestic and foreign sectors of the economy affected public sector revenue adversely in 1982, but this effect was offset by a sharp cutback in public sector expenditures. As a result, the overall public sector deficit turned out to be very close to the program target, although it was somewhat higher in relation to GDP than in the program because of the weaker than projected GDP (Table 2).

Although the overall fiscal deficit was in line with program projections, the share of the deficit financed with domestic resources was well in excess of the program targets because of a shortfall in external financing. Nevertheless, the growth in total banking system credit was in line with the program because of a much weaker than expected expansion in credit to the private sector associated with the sharp downturn in business activity. Also, private sector deposits in the banking system increased strongly last year, despite the deceleration in the growth of national income; but a substantial share of this growth may have reflected the accumulation of arrears in payments for foreign commercial transactions.

Despite the unexpected drop in exports, the current account of the balance of payments improved in 1982 in line with program projections, because of a sharp reduction in imports which reflected the decline in economic activity as well as an intensification of exchange controls. The improvement in the current account was offset by a deterioration in the capital account, mainly for private sector transactions, with the result that the overall balance of payments deficit amounted to nearly US$375 million (including an accumulation of payments arrears estimated at US$344 million). The buildup of arrears was precipitated by a large outflow of private capital, which reflected a withdrawal of foreign lines of credit, associated with both a hardening of credit terms of foreign creditors and suppliers and a speculative move on the part of local importers induced by fears of a devaluation of the quetzal.

Table 2. Guatemala: Macroeconomic Flows

(As per cent of GDP)

| | 1980 | 1981 | SBA 1982 | Est. 1982 | Program 1983 | Program 1984 |
|---|---|---|---|---|---|---|
| **I. Balance of Payments** | | | | | | |
| Current account | -2.2 | -6.5 | -4.6 | -4.2 | -3.2 | -3.0 |
| Trade balance | -1.0 | -4.3 | -2.9 | -2.1 | -1.2 | -1.0 |
| Net services and transfers | -1.2 | -2.2 | -1.7 | -2.1 | -2.0 | -2.0 |
| Capital account | -1.8 | 2.5 | 4.1 | -- | 3.2 | 3.2 |
| Nonfinancial private | -3.5 | -0.1 | 0.6 | -3.0 | 0.1 | 0.6 |
| Nonfinancial public | 1.2 | 1.2 | 2.5 | 0.9 | 1.3 | 1.4 |
| Financial 1/ | 0.4 | 1.4 | 1.0 | 2.1 | 1.7 | 1.1 |
| Overall balance | -4.0 | -4.0 | 0.5 | -4.2 | -- | 0.1 |
| **II. Public Sector Operations** | | | | | | |
| Current account surplus | 2.2 | 1.1 | 1.7 | 1.3 | 1.5 | 2.7 |
| General government | 2.0 | 0.9 | 1.5 | 1.0 | 0.9 | 2.1 |
| Revenue | (11.7) | (10.8) | (11.0) | (10.5) | (10.3) | (11.4) |
| Expenditure | (-9.7) | (-9.9) | (-9.5) | (-9.6) | (-9.4) | (-9.3) |
| State enterprises' operating surplus | 0.2 | 0.2 | 0.2 | 0.4 | 0.5 | 0.6 |
| Capital expenditures and net lending | 6.6 | 8.2 | 5.9 | 6.5 | 5.0 | 5.7 |
| Fixed investment | 5.9 | 7.9 | 5.6 | 6.6 | 4.7 | 5.0 |
| Other | 0.8 | 0.4 | 0.3 | -0.1 | 0.3 | 0.7 |
| Overall deficit | -4.4 | -7.1 | -4.2 | -5.1 | -3.6 | -3.0 |
| External financing | 1.2 | 1.2 | 2.5 | 0.9 | 1.3 | 1.4 |
| Internal financing | 3.2 | 5.9 | 1.7 | 4.2 | 2.2 | 1.6 |
| **III. Savings and Investment** | | | | | | |
| Gross domestic investment | 15.9 | 17.3 | 17.0 | 15.8 | 14.3 | 15.9 |
| Fixed capital formation | 16.4 | 16.6 | 16.5 | 14.7 | 13.5 | 14.9 |
| Public sector | (5.9) | (7.9) | (5.6) | (6.6) | (4.7) | (5.0) |
| Private sector | (10.6) | (8.8) | (10.9) | (8.1) | (8.8) | (9.9) |
| Inventory change | -0.5 | 0.7 | 0.5 | 1.0 | 0.8 | 1.0 |
| Investment = savings | 15.9 | 17.3 | 17.0 | 15.8 | 14.3 | 15.9 |
| External savings | 2.9 | 6.5 | 3.2 | 3.7 | 2.2 | 2.2 |
| Domestic savings | 13.0 | 10.8 | 13.8 | 12.1 | 12.1 | 13.7 |
| Public sector | (2.2) | (1.1) | (1.7) | (1.3) | (1.5) | (2.5) |
| Private sector | (10.8) | (9.7) | (12.1) | (10.8) | (10.6) | (11.2) |

Sources: Tables 4, 5 and 6; and Fund staff estimates.

1/ Includes SDR allocation.

## III. The Economic Program for 1983-84

The Government's program for 1983-84 is intended to build on the progress achieved in the fiscal area last year while improving the liquidity position of the Bank of Guatemala. The Guatemalan economy is at present facing a severe shortage of foreign liquidity which reflects, on the one hand, the withdrawal of normal trade financing and credit lines from foreign banks and suppliers and, on the other hand, the buildup by the Bank of Guatemala of substantial nonliquid claims on other members of the Central American Common Market which are unable to pay for Guatemalan exports because of their own weak financial position.

In the face of these difficulties, the Guatemalan authorities have designed a three-pronged strategy to deal with their liquidity crisis: (1) a system involving the orderly cancellation of payments arrears is being instituted to help restore Guatemala's access to private lines of credit abroad; (2) as a temporary bridging operation, the Bank of Guatemala intends to replace private credit lines which have been withdrawn with recourse to other foreign borrowing; and (3) a comprehensive tax reform is being put into place with the dual objective of (a) improving the buoyancy and efficiency of the existing tax system and (b) restructuring the existing incentives for production and exports with a view toward encouraging an economic recovery as quickly as possible.

The strategy just described is intended to facilitate the achievement of overall balance of payments equilibrium (including a reduction in payments arrears) in 1983 and a small overall surplus in 1984, after three years of substantial deficits.

In order to achieve the balance of payments objectives outlined above, the following performance criteria have been established for the duration of the stand-by arrangement: (a) ceilings on the net domestic assets of the Bank of Guatemala; (b) ceilings on the net domestic bank financing of the nonfinancial public sector; (c) limits on external borrowing by the public sector with maturities of less than ten years; and (d) targets for the reduction of payments arrears. Nonquantitative performance criteria relate to the payments and trade system and a midterm review of policies in early 1984. Table 3 summarizes the program's quantitative performance clauses through December 31, 1984.

### 1. Fiscal policy

The aim of the Government's fiscal program is to continue the adjustment effort initiated in 1982 leading to a reduction in the overall public sector deficit and in its domestic bank financing requirements. The adjustment effort has focused on the operations of the Central Government, which accounts for about three fourths of public sector transactions in Guatemala. During 1982 and 1983, the bulk of the adjustment effort has reflected expenditure restraint, whereas in 1984 most of the fiscal improvement is expected to come from revenue measures. All in all, the overall public sector deficit is to be reduced from the equivalent of 5 per cent of GDP in 1982 to 3-1/2 per cent of GDP in 1983 and to 3 per cent in 1984.

Table 3. Guatemala: Stand-By Arrangement Quantitative Performance Criteria

(In millions of quetzales)

| | 1983 | | 1984 | | | |
|---|---|---|---|---|---|---|
| | July-Sept. | Oct.-Dec. | Jan.-Mar. | Apr.-June | Jul.-Sept. | Oct.-Dec. |
| Net indebtedness of the nonfinancial public sector with the domestic banking system | | | | | | |
| Ceiling 1/ | 1,405 | 1,485 | 1,515 | 1,545 | 1,585 | 1,655 |
| Net domestic assets of the monetary authority | | | | | | |
| Ceiling 2/ | 775 | 780 | 775 | 770 | 775 | 810 |

| | 1983 | | | 1984 | | | |
|---|---|---|---|---|---|---|---|
| | July-Aug. | Sept. | Oct.-Dec. | Jan.-Mar. | Apr.-June | Jul.-Sept. | Oct-Dec. |
| Outstanding balance of payments arrears | | | | | | | |
| Limit 3/ | 400 | 385 | 350 | 325 | 300 | 275 | 250 |

| | Sept. 1983-Dec. 1984 |
|---|---|
| Public sector external indebtedness | |
| Limits on commercial borrowing | |
| 1-10 years | 300 |
| 1-5 years | 150 |
| Net use of short-term indebtedness 4/ | -- |

1/ These ceilings are to be adjusted upward to take account of any increase in government bond holdings by the Bank of Guatemala related to external debt service payments of DAG by the Bank of Guatemala through February in an amount of up to Q 38 million.

2/ These ceilings will be adjusted downward for any difference between actual and projected level of arrears shown in this table.

3/ These limits will be adjusted downward for any difference between actual and projected level of arrears as of August 31, 1983 and adjusted upward for any of that same difference which is converted into bonds after August 31, 1983 until December 31, 1983.

4/ Excludes financial institutions.

During 1983 the authorities intend to reduce the overall level of expenditure, both current and capital, for the second year in succession. Accordingly, central government expenditure will be reduced to 12 per cent of GDP in 1983, compared with 13 per cent in 1982 and 16 per cent in 1981 (Table 4). Current expenditures have been reduced as a result of a freeze on government salaries, which was instituted early in 1982, as well as cutbacks in public employment and underexecution of budgetary authorizations for purchases of goods and services. As regards investment spending, the Government's fiscal program has involved a reformulation and revision of the overall public investment program. This process has entailed the cancellation or postponement of many projects, and the restructuring of others to involve a higher content of foreign funding. In particular, two major hydroelectric projects were postponed until the end of the decade, and a proposal for a national beltway system was canceled.

As a complement to the Government's action on expenditures, the authorities have introduced a significant tax reform as of July 12, 1983, which is designed to enhance revenue yields and to improve the overall efficiency of the tax system.1/ The centerpiece of the reform is the substitution of a value added tax for the existing sales (stamp) tax. At the same time, the authorities established a reform of the corporate income tax which involves the simplification of the existing progressive rate structure and the introduction of a new tax on the net income of financial institutions. Finally, the reform changed the base of selective excises from a specific to an ad valorem basis and adjusted the rates of other indirect taxes. Conservatively estimated, the net effect of the tax package is to raise central government revenues by around Q 50 million (1/2 per cent of GDP) in 1983 and by about Q 160 million (1-1/2 per cent of GDP) in 1984.

The financial position of the rest of the public sector is expected to be in overall balance during the program period. This result is to be achieved by the application of the same expenditure guidelines to the decentralized agencies and state enterprises that apply to the Central Administration. Also, in the case of the main state enterprises, tariffs are being adjusted to maintain realistic levels. In the case of the National Electricity Institute (INDE), tariffs will be increased in order to maintain existing levels in real terms. Furthermore, the National Telecommunications Agency (GUATEL) has been adjusting its tariffs in line with World Bank recommendations. Among other things, revenue measures introduced in 1983 will allow GUATEL to transfer to the Central Government a 45 per cent share of its profits this year and next.

In view of these revenue and expenditure trends, the overall deficit of the public sector is projected to decline from Q 455 million in 1982 to about Q 325 million in 1983 and around Q 290 million in 1984. This will allow for a reduction in the internal financing requirement from around 4 per cent of GDP in 1982 to 2 per cent of GDP in 1983 and

1/ A detailed description of the tax reform is given in Appendix I.

Table 4. Guatemala: Central Government Operations

| | 1980 | 1981 | 1982 | Proj. 1983 | Proj. 1984 |
|---|---|---|---|---|---|
| | | | (In millions of quetzales) | | |
| Total revenue | 748 | 742 | 731 | 749 | 900 |
| Of which: tax reform | -- | -- | -- | 48 | 163 |
| Total expenditure | 1,116 | 1,380 | 1,142 | 1,094 | 1,203 |
| Current | 654 | 728 | 703 | 701 | 756 |
| Capital and net lending | 462 | 652 | 439 | 393 | 447 |
| Current account surplus | 92 | 13 | 27 | 48 | 144 |
| Overall deficit | -368 | -638 | -410 | -345 | -303 |
| External financing (net) | 98 | 115 | 97 | 121 | 129 |
| Internal financing (net) | 270 | 523 | 313 | 224 | 174 |
| Banking system | (311) | (453) | (321) | (240) | (166) |
| Other | (-41) | (70) | (-8) | (-16) | (8) |
| | | | (As a per cent of GDP) | | |
| Total revenue | 9.5 | 8.6 | 8.3 | 8.1 | 9.0 |
| Of which: tax reform | -- | -- | -- | 0.5 | 1.6 |
| Total expenditure | 14.2 | 15.9 | 12.9 | 11.8 | 12.0 |
| Current | 8.3 | 8.4 | 7.9 | 7.6 | 7.6 |
| Capital and net lending | 5.9 | 7.5 | 5.0 | 4.2 | 4.4 |
| Current account surplus | 1.2 | 0.1 | 0.3 | 0.5 | 1.4 |
| Overall deficit | -4.7 | -7.4 | -4.6 | -3.7 | -3.0 |
| External financing (net) | 1.3 | 1.3 | 1.1 | 1.3 | 1.3 |
| Internal financing (net) | 3.4 | 6.1 | 3.5 | 2.4 | 1.7 |
| Banking system | (3.9) | (5.2) | (3.6) | (2.6) | (1.6) |
| Other | (-0.5) | (0.9) | (-0.1) | (-0.2) | (-0.1) |

Sources: Ministry of Public Finance; Bank of Guatemala; and Fund staff estimates.

to 1-1/2 per cent of GDP in 1984. Domestic bank financing of the public sector is to decline from around Q 300 million in 1982 to Q 240 million in 1983 and to Q 166 million in 1984, which is consistent with the limits presented in Table 1 attached to the letter of intent.1/ Those limits are phased quarterly, taking into account seasonal factors.

## 2. Monetary policy

The main aim of the Government's monetary program is to slow down the growth of overall domestic bank credit to a rate consistent with approximate equilibrium in the overall balance of payments. During the program period (1983-84), the net domestic assets of the banking system are targeted to increase at an average annual rate of 6 per cent, compared with a rate of more than 30 per cent per year in the previous three-year period (Table 5). A significant part of this deceleration is to result from the fiscal program described above and the reduction in credit demands implicit in it. But a more important factor, at least in 1983, is the Government's intention to sterilize the domestic currency counterpart of the payments arrears accumulated prior to the start-up of the program.2/

In late June 1983, the Monetary Board resolved that all residents who had unsatisfied claims for foreign exchange pending authorization from the Bank of Guatemala had to validate these requests by the acquisition of stabilization bonds issued by the Bank equivalent to 100 per cent of the aforementioned request before the end of August 1983.3/ These bonds will be denominated in U.S. dollars, will mature in five years and carry an interest rate of 6 per cent. In the event that a foreign creditor or supplier willingly accepts these bonds from the local importer whose payment is in arrears, such bonds will bear an interest rate equivalent to one plus LIBOR.4/

In the monetary program of the Bank of Guatemala, it was assumed that the maximum amount of arrears reported by the Central Bank (i.e. US$400 million) would be sterilized during the initial two-month period stipulated in the Monetary Board resolution mentioned above. Also, most of the local currency counterpart of the arrears was assumed to

1/ The limits on banking system credit to the public sector may be raised by up to Q 38 million to reflect the reclassification of certain unclassified assets of the Bank of Guatemala as credit to the central government which are the counterpart of service payments on foreign debt of DAG made during 1982 and 1983 (through February).

2/ These arrears relate almost entirely to private sector obligations abroad, mainly for imports.

3/ Importers who purchase the bonds first will be those whose payments will be honored first. Those who do not acquire the bonds in the initial period can do so later, but only up to December 1983.

4/ In view of the exchange rate guarantee implicit in these bonds and their interest yield, the staff's judgment is that no multiple currency practice arises from Guatemala's arrears deposit scheme.

be reflected in banking system liabilities to the private sector (especially time and savings deposits). Accordingly, during 1983 the stock of quasi-money is projected to decline under the program, which implies a corresponding increase in the income velocity of money. This is so because for purposes of the program all Bank of Guatemala liabilities in the form of stabilization bonds will be counted as foreign reserve liabilities, rather than as banking system liabilities to the private sector.

Table 5. Guatemala: Summary Accounts of the Monetary Authority 1/

(In millions of quetzales)

| | December | | | | |
|---|---|---|---|---|---|
| | | | | Program | |
| | 1980 | 1981 | 1982 | 1983 | 1984 |
| Net foreign assets | 398 | 49 | -323 | -323 | -308 |
| Net international reserves | 398 | 49 | 21 | 27 | -58 |
| Payments arrears | -- | -- | -344 | -350 | -250 |
| Net domestic assets | 18 | 387 | 758 | 778 | 811 |
| Credit to public sector (net) | 436 | 880 | 1,136 | 1,376 | 1,542 |
| Credit to banks (net) | -135 | -134 | -318 | -33 | -80 |
| Credit | (130) | (150) | (86) | (287) | (267) |
| Deposits | (-265) | (-284) | (-404) | (-320) | (-347) |
| Medium- and long-term foreign liabilities | -80 | -165 | -240 | -386 | -489 |
| Counterpart arrears | -- | -- | 344 | -- | -- |
| Other | -203 | -194 | -164 | -179 | -162 |
| Currency issue | 416 | 436 | 435 | 455 | 503 |
| Memorandum items | | | | | |
| Total banking system credit | 1,587 | 2,246 | 3,000 | 3,073 | 3,376 |
| Banking system liabilities to the private sector | 1,859 | 2,088 | 2,388 | 2,305 | 2,510 |

Sources: Bank of Guatemala; and Fund staff estimates.

1/ Includes Bank of Guatemala and Securities Regulation Fund.

In the letter of intent, the authorities express their intention to follow a flexible interest rate policy. In November 1982, the ceilings on domestic interest rates were lowered to 12 per cent (for loans) and to 9 per cent (for deposits) in line with the downward trend of domestic inflation and foreign interest rates. These ceilings will be reviewed periodically to ensure that domestic interest rates in the banking system are generally positive in real terms and competitive with comparable rates abroad. Also, the structure of domestic interest rates was significantly improved recently with the removal of the stamp tax on bank credits, in the context of the tax reform mentioned earlier.

In view of the relatively weak forecast for domestic economic activity and foreign trade during the period of the requested stand-by arrangement and the Government's intention to sterilize the domestic counterpart of payments arrears, banking system liabilities to the private sector are projected to decline moderately in 1983 before rising by about 9 per cent in 1984. The loanable resources of the banking system are expected to be supplemented by a significant increase in medium- and long-term foreign liabilities amounting to Q 156 million in 1983 and Q 109 million in 1984. The domestic and foreign resources that are projected to accrue to the banking system would allow an expansion in credit to the private sector at a rate of about 11 per cent in 1983 and 7 per cent in 1984.

The net domestic assets of the Monetary Authority subject to ceiling are defined as the difference between its currency issue and its net international reserves.1/ The ceilings on the net domestic assets of the Monetary Authority referred to in paragraph 9 and Table 2 of the attached letter of intent are consistent with the estimated growth of banking system loanable resources as well as with the bank financing of the public sector deficit, the projected credit expansion to the private sector, and the target for net official international reserves (see Table 4). The credit ceilings will be adjusted downwards to take account of any difference between the maximum amount of arrear bonds assumed in the program and the actual amount issued by the Bank of Guatemala. These ceilings have been established on a quarterly basis and take into consideration the seasonality of credit demands.

### 3. External policies

The Guatemalan Government's financial program for 1983-84 seeks to bring about a significant improvement in the overall balance of payments during the period of the contemplated stand-by arrangement. The current account deficit is projected to decline from around 4 per cent of GDP in 1982 to 3 per cent in 1983 and 1984, mainly as a result of an improvement in the trade balance (Table 6). Exports are forecast to decline moderately in 1983, for the third year in a row, as a result of weak international demand for Guatemala's main commodity exports (coffee, cotton, and bananas) and weak regional demand for Guatemala's manufactured exports. But this decline is to be more than offset by a further compression of imports which reflects the continued weakness of domestic economic activity and the effects of monetary and fiscal

1/ The latter includes as a foreign reserve liability any counterpart deposit arising from payments arrears.

restraint. During 1984 both exports and imports are projected to increase moderately, in line with some recovery in economic activity. The projected level of imports for next year takes into account a significant substitution effect of hydroelectric for thermal power stemming from the coming-on-stream of the Aguacapa and Chixoy hydroelectric projects.

Table 6. Guatemala: Summary Balance of Payments

(In millions of U.S. dollars)

| | 1980 | 1981 | 1982 | Proj. 1983 | Proj. 1984 |
|---|---|---|---|---|---|
| Current account | -176 | -565 | -371 | -297 | -302 |
| Exports, f.o.b. | 1,520 | 1,299 | 1,200 | 1,140 | 1,215 |
| Imports, c.i.f. | -1,598 | -1,673 | -1,388 | -1,250 | -1,318 |
| Net services | -208 | -282 | -248 | -224 | -244 |
| Transfers | 110 | 91 | 65 | 37 | 45 |
| Capital account | -143 | 216 | -1 | 297 | 317 |
| Private | -273 | -12 | -279 | 13 | 65 |
| Long term | (138) | (163) | (74) | (35) | (50) |
| Short term | (-411) | (-175) | (-353) | (-22) | (15) |
| Official | 94 | 107 | 82 | 124 | 137 |
| Financial | 36 | 121 | 196 | 160 | 115 |
| Bank of Guatemala | (13) 1/ | (91) 1/ | (75) | (146) | (103) |
| Banks | (10) | (-4) | (8) | (9) | (10) |
| Other | (13) | (34) | (113) | (5) | (2) |
| Overall balance | -319 | -349 | -372 | -- | 15 |
| Net international reserves (increase -) | 319 | 349 | 28 | -6 | 85 |
| Arrears (decrease -) | -- | -- | 344 | 6 | -100 |

Sources: Bank of Guatemala; and Fund staff estimates.

1/ Includes SDR allocation.

Net capital inflows are projected to increase during the period of the stand-by arrangement, as a result of public sector borrowing from multilateral lending agencies to finance on-going investment programs and an increase in trade-related financing by the Bank of Guatemala. On the basis of these inflows, the current account deficit projected for 1983-84 would appear to be compatible with approximate overall balance of payments equilibrium. The overall balance is defined to include changes in commercial payments arrears. These arrears are scheduled to be reduced by US$50 million during the second half of 1983 from a peak of US$400 million at midyear, and by US$100 million during 1984.

During the period of the stand-by arrangement, the Government intends to increase its recourse to foreign borrowing on commercial terms within prudent limits. Accordingly, the contracting of foreign commercial credits with maturities from one to ten years by the public sector is not to exceed US$300 million during the period of the stand-by arrangement. Within this overall limit, the contracting of loans with maturities from one to five years is not to exceed US$150 million. These limits apply to public financial and nonfinancial institutions, as well as private sector debt with official guarantee, but exclude disbursements under the Mexican-Venezuelan oil facility and any loans connected with a rescheduling of external payments arrears or existing indebtedness. It is anticipated that about half of the contemplated amount under the debt limits will be accounted for by the trade-related credits of the Bank of Guatemala referred to earlier; the remainder would be accounted for by suppliers credits and commercial borrowing by the main state enterprises associated with development projects. The net use of short-term commercial borrowing by the nonfinancial public sector has been minimal in recent years and is not to increase over the period of the stand-by arrangement.

Guatemala has traditionally maintained an exchange and trade system free of restrictions and transfers for current international transactions. In 1980 exchange control procedures were introduced to restrain private capital outflows and transfers of capital disguised as current transactions. Among other things, limits were established on invisible payments abroad which were reduced in September 1981 and again, in the case of travel, in November 1982. At the same time, quotas were placed on import payments requiring foreign exchange from the Bank of Guatemala.

In the attached letter, the Guatemalan authorities have affirmed that the existing exchange restrictions are temporary measures and will be removed as soon as conditions permit. In addition, the authorities have indicated their intention to apply the existing limits on exchange requests in a flexible manner in the sense that requests in excess of the stipulated amounts will be permitted in duly authenticated cases. Specifically, before January 15, 1984 the authorities intend to establish a system whereby bona fide requests for all invisible payments except nonbusiness travel abroad would be honored. For the time being, the following exchange restrictions subject to the Fund's jurisdiction remain in effect: (1) quotas on import payments; (2) a deposit requirement on foreign exchange requests for travel abroad; (3) limits on nonbusiness travel abroad; (4) limits on student expenditures abroad; (5) limits on family remittances abroad; (6) limits on the remittance of earnings in Guatemala of Guatemalan residents abroad; (7) limits on the remittance abroad of earnings of foreign workers in Guatemala; and (8) arrears on payments and transfers for current international transactions.1/ The authorities have also committed themselves to review with the Fund before May 31, 1984 the progress made in the liberalization of the exchange system with a view toward removing the remaining restrictions before the end of the stand-by arrangement.

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1/ The exchange and trade system of Guatemala is described in detail in Appendix III of SM/83/79.

In framing their adjustment program, the Guatemalan authorities plan to maintain the existing parity for the Guatemalan quetzal (Q 1 per U.S. dollar). This decision appears appropriate on the basis of the prospects for an improvement in the balance of payments position of Guatemala implicit in the adjustment program described above and on the tendency demonstrated over the medium term for Guatemala to maintain a rough equivalence between increases in domestic costs and average price rises in its major trading partners. As shown in the chart on effective exchange rate indices presented in Appendix VI, the trade-weighted effective exchange rate, adjusted for relative prices, appreciated by 10 per cent in 1981 and by 2-1/2 per cent in 1982, mainly because of the strength of the U.S. dollar, but these changes were preceded by a period of four years in which the real effective exchange rate depreciated by 8 per cent.

The decision of the Guatemalan authorities to maintain the existing parity is also linked with their intention to improve export incentives by means of the tax reform mentioned earlier. This reform is designed to improve export competitiveness in three ways: first, the substitution of a value-added tax for the existing stamp tax allows for a rebate of domestic taxes on exports which is not possible at the present time; second, the reform calls for the progressive elimination of all taxes on exports over the next three years; and third, the reform introduces tax credits (CATS) of 10 per cent and 15 per cent for nontraditional exports outside the Central American Common Market.

## IV. Medium-Term Outlook

The outstanding external indebtedness of the public sector (including liabilities to the IMF) amounted to US$1.3 billion at the end of 1982 (15 per cent of GDP), and debt service payments on this indebtedness amounted to 8-1/2 per cent of exports of goods and services last year (Table 7). Although Guatemala's current debt position is relatively favorable compared with other developing countries, the debt service burden of the country is projected to rise sharply over the next few years, especially if the payments arrears of the Bank of Guatemala are taken into account.

The medium-term outlook for Guatemala's external position is governed largely by the following assumptions. First, export growth is expected to be relatively modest over the next five years with the recent peak of 1980 recovered only by 1986. A resurgence of growth in 1985 and beyond is associated with the anticipated recovery of growth in the world economy on the one hand, and the delayed effects of the export incentive measures established in the tax reform of 1983 described earlier on the other.

Second, the public sector foreign borrowing for the period 1984-88 is consistent with that projected in the Government's public investment program for the next four years. The program continues to emphasize

Table 7. Guatemala: Summary of External Debt Projections

| | Actual | Projected | | | | | |
|---|---|---|---|---|---|---|---|
| | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
| (In millions of U.S. dollars) | | | | | | | |
| Outstanding public debt (at the end of the year) 1/ | 1,666 | 1,998 | 2,230 | 2,437 | 2,643 | 2,871 | 3,179 |
| Nonfinancial | 796 | 920 | 1,057 | 1,155 | 1,295 | 1,505 | 1,731 |
| Financial 2/ | 870 | 1,078 | 1,173 | 1,282 | 1,348 | 1,366 | 1,448 |
| Net drawings 3/ | | | | | | | |
| Total including IMF | 264 | 326 | 332 | 307 | 306 | 278 | 308 |
| Debt service payments | | | | | | | |
| Total | 113 | 236 | 335 | 470 | 501 | 423 | 398 |
| Amortization | (56) | (121) | (203) | (327) | (348) | (265) | (221) |
| Interest | (57) | (115) | (132) | (143) | (153) | (158) | (177) |
| Total excluding arrears | 113 | 160 | 214 | 356 | 394 | 371 | 398 |
| Amortization | (56) | (71) | (103) | (227) | (248) | (215) | (221) |
| Interest | (57) | (89) | (111) | (129) | (146) | (156) | (177) |
| Total excluding IMF and arrears | 107 | 151 | 200 | 282 | 310 | 306 | 315 |
| Amortization | (56) | (71) | (103) | (175) | (194) | (183) | (168) |
| Interest | (51) | (80) | (97) | (107) | (116) | (123) | (147) |
| (Ratios in per cent) | | | | | | | |
| Outstanding debt/GDP | | | | | | | |
| Total | 18.8 | 21.6 | 22.2 | 22.3 | 21.8 | 21.1 | 20.8 |
| Total excluding arrears | 14.9 | 17.8 | 19.7 | 20.9 | 21.4 | 21.1 | 20.8 |
| Net drawings/GDP | 3.0 | 3.5 | 3.3 | 2.8 | 2.5 | 2.0 | 2.0 |
| Debt service/export of goods and services | | | | | | | |
| Total | 8.5 | 18.6 | 24.8 | 31.1 | 28.9 | 21.2 | 17.3 |
| Total excluding arrears | 8.5 | 12.6 | 15.8 | 23.6 | 22.7 | 18.6 | 17.3 |
| Total excluding arrears and IMF | 8.0 | 11.9 | 14.8 | 18.7 | 17.9 | 15.3 | 13.7 |
| (In millions of U.S. dollars) | | | | | | | |
| Memorandum items | | | | | | | |
| GDP | 8,859 | 9,264 | 10,034 | 10,937 | 12,107 | 13,608 | 15,295 |
| Exports of goods and services | 1,335 | 1,268 | 1,352 | 1,510 | 1,736 | 1,997 | 2,297 |

Source: Statistical Appendix Table 15.

1/ Maturities of one year or more.
2/ Includes IMF and arrears.
3/ Excludes payment of arrears.

projects of an infrastructural nature, mainly in electrification, road building and telecommunications. The plan involves gross foreign borrowing on the order of US$350 million in 1984, rising to around US$500 million in 1987-88.

Third, the current account deficit of the balance of payments is projected to be in the range of 3 per cent to 4 per cent of GDP over the next four to five years, and most of this deficit would be covered by the external borrowing of the public (financial and nonfinancial) sector just referred to. Private capital inflows, although strong in the period prior to 1979, are projected to recover only marginally during the period under review.

Finally, it is assumed that payments arrears of the Bank of Guatemala will be canceled at a rate of US$100 million per year.

On the basis of these assumptions, it is projected that total indebtedness of the public sector (including payments arrears and liabilities to the Fund) will rise from around 19 per cent of GDP at the end of 1982 to 22 per cent in 1984-85, after which period, the ratio of debt to GDP will tend to decline gradually. The projected trend of debt service payments over the next five years is much more marked than that of outstanding public indebtedness. Total debt service payments as a proportion of exports of goods and services will rise from 8-1/2 per cent in 1982 to 18-1/2 per cent in 1983, to 25 per cent in 1984 and to a peak of 31 per cent in 1985. This sharp rise over the next three years represents the combined influence of (1) heavy repayments of indebtedness contracted prior to the end of 1982; (2) interest payments on commercial borrowing undertaken in 1983-84; (3) large cancellations of payments arrears in 1984-85; and (4) large repurchase obligations to the Fund beginning in 1985.

After reaching a peak level of over 30 per cent in relation to exports of goods and services in 1985, the debt service ratio is projected to fall sharply thereafter, to 17 per cent in 1988. This result is determined mainly by the elimination of payments arrears, a slowdown in repayments on indebtedness existing prior to the end of 1982, and some reduction in service payments to the Fund.

## V. Staff Appraisal

After several years of strong economic growth and foreign reserve accumulation, Guatemala's economic and financial position began to deteriorate sharply in 1979. The regional political crisis in Central America, together with the adverse effects of the world recession, created a climate of uncertainty in Guatemala and a downward spiral of trade, investment, and economic activity. In response to the ensuing domestic economic crisis, the Guatemalan authorities pursued a countercyclical strategy based on monetary and fiscal expansion during 1980-81 which exacerbated the adverse effects on the balance of payments of the unfavorable external factors just mentioned.

During 1982, the Guatemalan government implemented an adjustment program designed to halt the balance of payments deterioration of the previous years. Despite a much weaker base of domestic economic activity and foreign trade than assumed in the program, the target for the overall fiscal deficit was achieved by a policy of strict expenditure control and a major revision of the public investment program. The balance of payments objective, however, was not met and the loss of net official international reserves was contained only on account of an intensification of exchange restrictions, including the substantial accumulation of payments arrears.

During 1983-84, the Guatemalan authorities are resolved to continue their adjustment effort in order to bring about overall balance of payments equilibrium. The Government's fiscal program calls for the continuation of a policy of strict expenditure control, together with the implementation of a significant tax reform. The latter is especially welcome after several years of erosion of the tax effort. In the staff's view, such a reform will not only make the tax system more efficient, but will also help to restructure incentives for domestic production and exports.

The monetary program calls for a sizable sterilization of the domestic counterpart of existing payments arrears which will help to achieve the credit and balance of payments objectives of the program. At the same time, the authorities are committed to pursue a flexible interest rate policy. In view of the past record in this area, the staff would urge the authorities to respond quickly to any significant changes in international financial markets, and to take steps to make the domestic interest rate system more responsive to adjustments in domestic interest rate ceilings.

The staff welcomes the Government's intention to honor bona fide requests for foreign exchange for certain invisible payments as well as to eliminate exchange restrictions during the period of the arrangement and to begin an orderly procedure for the cancellation of payments arrears. Such a policy is necessary for the purpose of restoring the confidence of Guatemala's foreign creditors and suppliers. In view of the policies and intentions of the authorities in this area, the staff recommends approval of Guatemala's exchange restrictions.

The program allows for some increase in foreign financing of the public sector to allow for a gradual adjustment effort in a context of a tight domestic credit management. While the magnitude of the debt itself is not unduly large, external debt service payments, in large part on account of the cancellation of payments arrears accumulated through mid-1983, are scheduled to rise sharply through 1985-86. For this reason, the staff urges the authorities to exercise caution in their future reliance on foreign commercial credits, lest their balance of payments adjustment be impaired.

The decision to maintain the existing parity of the Guatemalan quetzal with the U.S. dollar is consistent with the Government's long run tradition of financial discipline, and consequently it underscores the critical need to pursue restrictive demand management policies and to maintain a tight control over domestic costs during the difficult, current economic conjuncture. Over the medium term, the Government's exchange rate policy will only be sustainable if its export promotion policies take hold and sound economic recovery is attained.

## VI. Proposed Decisions

The staff is of the opinion that the policies which the Guatemalan authorities have submitted to the Fund with a request for a stand-by arrangement constitute a substantial effort to return the economy to a sound financial and economic path, and that they are, therefore, worthy of Fund support. Accordingly, the following draft decisions are proposed for adoption by the Executive Board:

### I. Stand-by Arrangement

1. The Government of Guatemala has requested a stand-by arrangement for the period August --, 1983-December 31, 1984, for an amount equivalent to SDR 114.75 million.

2. The Fund approves the stand-by arrangement attached to EBS/83/163.

3. The Fund waives the limitation in Articles V, Section 3(b)(iii).

### II. Approval of Exchange Restrictions

The Fund grants approval for the retention by Guatemala of the restrictions on payments and transfers described in EBS/83/163 until May 31, 1984, or the time of the mid-term review of the stand-by arrangement, whichever is earlier.

## Guatemala: The Reform of the Tax System

This appendix summarizes the main features of the tax reform which was enacted July 12 and entered into effect on August 1, 1983. The fiscal package involves the introduction of new taxes, the replacement of existing taxes, and the elimination of a number of outmoded taxes. A key objective of the tax reform is to increase revenue yields. By and large, the most important measure contemplated in this area is the replacement of the sales (stamp) tax by a new value added tax. The reform also aims at making the tax system more efficient and includes measures to improve tax administration and control procedures. In addition, the tax reform envisages changes in the structure of incentives for production and export with a view to stimulating domestic activity and providing additional balance of payments support.

### 1. Value added tax

As of August 1, 1983, the current 3 per cent cascading stamp tax on sales was substituted by a new value added tax. The traditional stamp tax on specified legal documents remains operative. The new value added tax will apply to all goods and services sold in the domestic market irrespective of country of origin, with the exception of the following: wages and salaries, a basket of basic consumer goods;1/ petroleum and selected petroleum derivatives; selected inputs into agricultural production; banking, insurance, and financial services as well as sales of low-income housing financed with government financial aid or otherwise built under a cooperative arrangement. Exports of goods and services are exempt from the tax since by definition they are sold abroad. The abolition of the stamp tax on wages and salaries and on financial transactions such as bank loans and interest-bearing accounts and their exclusion from the new value added tax is noteworthy.

The new value added tax is expected to generate revenue in excess of the projected yield of the stamp tax which it replaces amounting to Q 58 million in 1983 and Q 199 million in 1984 (Table 8). The increase in revenue will stem mainly from two factors. First, the 10 per cent rate established for the new tax represents a higher fiscal burden than the stamp tax equivalent currently in force. Secondly, the rationalization process that will accompany the introduction of the value added tax, together with the administrative procedures that have been devised for its implementation, are expected to reduce significantly the amount of underinvoicing of tax obligations and other forms of tax evasion

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1/ The basket of basic consumer goods is made up of more than 80 items including food products such as: corn, flour, bread, fresh vegetables, dairy products, fresh fish, all meats, cooking oils, edible fats, salt and vinegar; hygenic products such as: soap, toothpaste, and toothbrushes; medicines; orthopaedic aids; selected educational expenses; all publications; ground transportation, rents paid on family housing; and the use of up to 150 kw of electric energy and 30,000 liters of drinkable water per month.

under the stamp tax. Under the new scheme, at each stage of the production and marketing process a tax credit is granted against the tax obligation generated in that stage for an amount equal to the tax charged by suppliers. Hence, it is in the interest of taxpayers to demand a tax invoice from their respective suppliers, thereby enabling the implementation of a double control procedure on tax declarations.

Table 8. Guatemala: Net Effect of Tax Reform Measures

(In millions of quetzales)

| | 1983 | 1984 |
|---|---|---|
| Net additional revenue | 48 | 163 |
| Revenue increases | 118 | 393 |
| Value added tax | 110 | 369 |
| Income tax: financial institutions | 2 | 5 |
| Soft drinks | -- | -- |
| Alcoholic beverages | 2 | 6 |
| Beer | 2 | 7 |
| Wine and cider | -- | 1 |
| License fees (patente) | 1 | 2 |
| Exit tax | 1 | 2 |
| Revenue decreases | 70 | 230 |
| Stamp tax on sales | 52 | 170 |
| Stamp tax on credit | 69 | 24 |
| Export taxes | 9 | 20 |
| Income tax | -- | 15 |
| Minor taxes | -- | 1 |
| Revenue-neutral measures | -- | -- |
| Cigarette tax law | -- | -- |

Source: Fund staff estimates.

2. Changes in the income tax law: corporate income

Corporate income has been taxed according to a progressive rate scale which discouraged increases in the volume of operations of enterprises.1/ The new tax reduces the number of tax brackets from 60 to 5

1/ Details on the corporate income tax as it operated prior to the reform are provided in SM/83/71 (Appendix A).

and contemplates less progressive rates (Table 9). Corporate income between Q 80,000 and Q 2,000,000 will be taxed according to a 30 per cent rate as opposed to the previous progressive rate which started at 29.5 per cent for income between Q 80,000 and Q 90,000 and rose to 48 per cent for income of Q 500,000 and above. An important novelty in the law is that banks, financial enterprises, and insurance companies are made liable to a new minimum tax of 20 per cent on their net income.

Table 9. Guatemala: New Rate Scale for Corporate Income Tax

(In quetzales)

| Income | Tax | Plus (Per cent) |
|---|---|---|
| Up to 5,000 | -- | 5.0 |
| 5,000 | 250 | 11.3 |
| 23,000 | 2,284 | 24.0 |
| 80,000 | 15,964 | 30.0 |
| 2,000,000 | 591,964 | 42.0 |

Source: Ministry of Finance.

The tax base applicable to corporate income is changed to include dividends and any other form of profit distribution to shareholders, as well as credits and transfers from the subsidiaries of multinational enterprises to their headquarters abroad. The tax paid by enterprises will constitute a tax credit for the personal income tax declarations of shareholders, thereby establishing a procedure that will avoid double taxation while encouraging the reporting of dividends.

Credits and transfers to multinationals, as well as repatriated income from foreign investment, are liable to a new 12.5 per cent tax that will be established to substitute for the existing taxation scheme on those operations. The setting of the latter rate is intended to be consistent with the objective of making the total tax burden on foreign investment comparable to that of other countries offering similar investment opportunities, in an effort not to discourage foreign investment into the country.

### 3. Export incentives

In order to promote exports, the new law contemplates two important changes with regard to exports. First, the fiscal package provides for the gradual elimination of all existing export duties (except municipal taxes) which currently affect traditional exports (coffee, cotton, sugar, bananas, beef, and shrimp). The abolition of export duties will be enacted according to the following calendar: 50 per cent as of July 12, 1983, 75 per cent as of July 1, 1984, with complete abolition to be effective as of July 1, 1985.

The new law grants additional benefits to export activities. With a view to emphasizing the importance of diversifying the export base and opening new markets for existing exports, the fiscal package grants tax credit certificates (CATs) amounting to 10 per cent of the f.o.b. value of currently exported nontraditional goods, if these are exported to markets with which Guatemala does not have bilateral or multilateral free trade agreements. Moreover, new nontraditional exports to the aforementioned markets will be granted a CAT equivalent to 15 per cent of export value in order to encourage further investment in new export activities in Guatemala. This benefit also applies to new nontraditional exports to countries with which Guatemala has bilateral or multilateral trade agreements if the products are not included in such agreements.

### 4. Changes in selective excise taxes

The tax reform contemplates the rationalization of certain excise taxes by means of changes in the tax base from a specific to an ad valorem basis. The goods affected by the change are wine, beer, and all other alcoholic beverages, as well as both carbonated and noncarbonated soft drinks. As can be seen from Table 10, tax rates vary from 40 per cent for beer to 20 per cent for wine and 1 per cent for soft drinks.

Table 10. Guatemala: Changes in Selected Excise Taxes

| Good | Current Specific Tax Rate | Proposed Ad Valorem Tax Rate 1/ |
|---|---|---|
| Distilled alcoholic beverages | Q 1.50 per liter | 80 per cent up to Q 2.50 and 20 per cent on the excess |
| Beer and other fermented beverages | Q 0.29 per liter | 40 per cent |
| Wine | Q 0.15 per liter | 15 per cent |
| Cider | Q 1.50 per liter | 10 per cent |
| Soft drinks | Q 0.01 per 350 ml | 1 per cent |
| Champange and vermouth | ... | 10 per cent |

Source: Ministry of Finance.

1/ Applicable on wholesale price of domestically produced goods or the tariff inclusive price of imports.

In practice the change will yield a slight increase in additional revenue (see Table 8) since the proposed rates imply moderate increases in the ad valorem equivalent of the specific tax rate currently applicable to the list of goods. This is consistent with the objective of not increasing the price for these items to a level that would encourage smuggling.

5. Increase in fees for liquor licenses

Currently, businesses selling alcoholic beverages in Guatemala are required to purchase a license. The new law contemplates a small increase in the license fee charged for the sale of alcoholic beverages which has not been revised since 1948. The law also abolishes the earmarking of revenue from this source, with the exception of funds allocated to municipalities.

6. Increase in exit tax

The prevailing exit tax is applicable to individuals leaving Guatemala by ground and other transportation at the rate of Q 1.5 and Q 5.0, respectively. The new law increases the tax rate to Q 3.5 and Q 12, respectively.

7. Cigarette tax

Production and consumption of tobacco and its byproducts are currently taxed in Guatemala. Decree 65 (10/12/79) earmarked certain revenue from this source to be used for the support of sports and recreational activities. The new law contemplates the abolition of this earmarking of revenue and instead makes all revenue from tobacco taxes available for general budgetary purposes.

8. Elimination of other taxes

A total of 305 outmoded taxes are being eliminated whose yield is marginal in comparison with the administrative cost entailed. These include: 282 different sanitary taxes, taxes on molasses, turpentine, rooster fighting, lizard hunting, card games, raffles, possession of guns, sale of secondhand goods, and taxes on peddlers, among others. The estimated loss in revenue from these tax items is expected to amount to Q 1 million in 1984.

## Fund Relations with Guatemala
(June 30, 1983)

Date of membership: December 1945.

Status: Article VIII.

Quota: SDR 76.5 million. (Proposed maximum quota of SDR 108.0 million under the Eighth General Review.)

Fund holdings of quetzales:

| | | Millions of SDRs | Per Cent of Quota |
|---|---|---|---|
| Total | | 172.1 | 225.0 |
| Of which: | credit tranches | 19.1 | 25.0 |
| | compensatory financing | 76.5 | 100.0 |

SDR Department:

| | Millions of SDRs | Per Cent of Allocation |
|---|---|---|
| Net cumulative allocation | 27.7 | 100.0 |
| Holdings | 0.06 | 0.22 |

Direct distribution of profits from gold sales (July 1, 1976-July 31, 1980): US$5.7 million.

Gold distribution: 30,810 fine ounces (four distributions).

Contribution to SFF: The equivalent of SDR 30 million in dollars, of which SDR 8.4 million were used and repaid in advance on February 8, 1982 (EBS/82/22). The unused balance (equivalent to SDR 21.6 million) is not being called upon at present as Guatemala's balance of payments and reserve positions are not sufficiently strong.

Exchange system: All transactions take place at the fixed exchange rate of US$1 per quetzal.

Last Article IV consultation: February-March 1983 completed by the Executive Board on June 1, 1983 (EBM/83/77).

Guatamala: Financial Relations with the World Bank Group

(In millions of U.S. dollars)

A. IBRD/IDA/IFC Operations (as of March 31, 1983)

| | Disbursed | Undisbursed |
|---|---|---|
| IBRD/IDA loans | | |
| Agriculture | 4.0 | -- |
| Education | 20.6 | 4.4 |
| Power | 133.0 | 16.0 |
| Urban development | 18.7 | 1.3 |
| Transport | 19.2 | 16.0 |
| Telecommunications | 39.2 | 2.8 |
| Total | 234.7 | 40.5 |
| Of which: repaid | 50.2 | |
| outstanding | 184.5 | |
| IFC investments 1/ | 181.1 | -- |

B. IBRD/IDA Loan Disbursements 2/

| | 1979 | 1980 | 1981 | 1982 | Projected 1983 | Projected 1984 |
|---|---|---|---|---|---|---|
| Net disbursements | 25.3 | 45.2 | 23.8 | 27.2 | 7.0 | 10.2 |
| Gross disbursements | 27.3 | 48.2 | 28.7 | 34.8 | 17.0 | 21.7 |
| Amortization | 2.0 | 3.0 | 4.9 | 7.6 | 10.0 | 11.5 |

Source: IBRD.

1/ Total gross commitments.
2/ Financial year ending June 30.

## Guatemala: Principal Assumptions and Main Elements of the Financial Program, 1983-84

### 1. Principal assumptions of the program 1/

| | 1983 | 1984 |
|---|---|---|
| **a. Gross domestic product** | | |
| Real GDP | -2.3 | 1.0 |
| Nominal GDP | 4.6 | 8.3 |
| GDP deflator | 7.0 | 7.2 |
| **b. Trade and official capital inflows** | | |
| Export value | -5.0 | 6.6 |
| Of which: coffee | (-7.6) | (-3.2) |
| cotton | (-20.6) | (11.4) |
| bananas | (-40.3) | (81.7) |
| Import value | -9.9 | 5.4 |
| Terms of trade | 1.0 | -1.2 |
| Export unit value | (2.7) | (3.0) |
| Import unit value | (1.7) | (4.3) |
| Net disbursement of medium- and long-term foreign official capital (millions of U.S. dollars) | 284 | 252 |
| Of which: nonfinancial public sector | (124) | (137) |
| Bank of Guatemala | (146) | (103) |
| **c. Monetary variables** | | |
| Growth rate in bank liabilities to the private sector | -3.5 | 8.9 |
| Increase in banking system domestic credit (millions of quetzales) | 73 | 303 |
| Increase in banking system credit to public sector (millions of quetzales) | 240 | 166 |
| Increase in Bank of Guatemala's net domestic assets (millions of quetzales) | 20 | 33 |
| **d. Fiscal variables** | | |
| Growth in Central Government revenues | 2.6 | 20.2 |
| Growth in Central Government expenditures | -4.0 | 10.0 |
| Of which: current | -0.3 | 7.8 |
| capital and net lending | -10.4 | 13.7 |

1/ Annual percentage changes, unless otherwise specified.

2. Main elements of the financial program

a. Fiscal policy

(1) Main targets

The main aim of the fiscal program is to reduce the overall deficit of the nonfinancial public sector from 5 per cent of GDP in 1982 to 3-1/2 per cent in 1983 and to 3 per cent in 1984. The projected improvement of the financial position of the public sector is expected to reduce its dependence upon domestic financing. The domestic financing of the public sector deficit is expected to be reduced from 4 per cent of GDP in 1982, to 2 per cent in 1983 and to 1-1/2 per cent in 1984.

(2) Fiscal measures

The Government has launched a major tax reform which is designed to raise revenue yields and improve the overall efficiency of the tax system. The cornerstone of this reform is the substitution of a value added tax (VAT) of 10 per cent for the existing cascade-type stamp tax. The VAT, enacted in July 1983, is expected to yield, on a net basis, additional revenues of Q 58 million in 1983 (1/2 per cent of GDP) and Q 200 million in 1984 (2 per cent of GDP). The tax reform also envisages the elimination of a number of outmoded taxes whose yield has been minimal. In addition, in July 1983 the Government introduced a change in the base of the selective excise taxes from a specific to an ad valorem basis. The Government also reformed the income tax system, at the corporate level, simplifying the existing progressive rate system and introducing a new minimum tax on the income of financial institutions. The government also included in the reform an export bonus scheme (CATs) for new nontraditional exports and a reduction of export taxes to increase the profitability of existing agricultural exports. The tax reform is projected to yield on a net basis additional central government revenue of 1/2 per cent of GDP in 1983 and 1-1/2 per cent of GDP in 1984.

On the expenditure side, the Government plans to continue with its austerity program as regards outlays on goods and services and its reformulation of the public investment program. Total government outlays are projected to be reduced from 13 per cent of GDP in 1982 to 12 per cent in 1983 and 1984. Total capital expenditure in nominal terms in 1983, including net lending for reconstruction, is projected to be below the 1981 and 1982 levels. Public sector fixed investment is expected to be reduced from 6-1/2 per cent of GDP in 1982 to 5 per cent in 1984. The rest of the public sector is expected to be in approximate overall equilibrium in 1983 and 1984. This result will be ensured by tight expenditure controls and adjustments of the tariffs and charges of the main state enterprises, such as the Electricity Authority (INDE) and the Telecommunications Agency (GUATEL).

b. Monetary policy

Monetary policy is aimed at achieving equilibrium in the overall balance of payments in 1983 and a US$15 million surplus in 1984. Consistent with this aim, total net credit of the banking system is expected to increase by Q 73 million in 1983 and by Q 303 million in 1984 (or a change of 2-1/2 per cent and 10 per cent, respectively). The increase in net credit of the banking system to the nonfinancial public sector is programed not to exceed Q 240 million in 1983 and Q 166 million in 1984 (or an increase of 19 per cent and 11 per cent over the previous year, respectively). In line with the objectives of the monetary program, net domestic assets of the monetary authority have been targeted to increase by no more than Q 20 million in 1983 and Q 33 million in 1984 (or an annual change of 2-1/2 per cent and 4-1/2 per cent, respectively). The monetary program also calls for the sterilization of counterpart deposits in quetzales against external payments arrears.

To complement the objectives of the monetary program, the Government intends to pursue a realistic interest rate policy. At present, the ceilings on domestic interest rates in the banking system are set at 12 per cent (for loans) and 9 per cent (for deposits), consistent with the prevailing rate of domestic price inflation and the level of interest rates in foreign financial markets. The interest rate ceilings will be reviewed periodically to ensure that they are positive in real terms and competitive with those abroad. In addition, the structure of domestic interest rates was improved due to the elimination of the stamp tax on bank credits stipulated in the tax reform introduced in July 1983.

c. Price and wage policies

Domestic prices will continue to reflect essentially the interplay of market forces during the program period, except for certain essential consumer goods and medicines subject to price control. These controls will be administered flexibly to preclude the emergence of distortions.

The Government sets minimum wage levels for the private sector, but in general private sector wages are determined through collective bargaining arrangements. As regards the public sector, the Government has decided to continue the wage freeze introduced in early 1982.

d. External policies

The financial program has been designed to allow for the reduction of external payments arrears of at least US$50 million in the second half of 1983 and US$100 million in 1984. To monitor the arrears, all existing arrears and future requests for foreign exchange will be backed by a counterpart deposit in local currency equivalent to 100 per cent of the amount requested. These deposits against payments arrears will be sterilized in a special account of the Bank of Guatemala. In exchange for these deposits, both old and new, importers will receive five-year stabilization bonds issued by the Bank of Guatemala which will bear interest at an annual rate of 6 per cent, or LIBOR plus one in the event that these are accepted abroad by foreign creditors.

As regards exchange rate restrictions, the authorities have confirmed that these are temporary measures and are expected to be eliminated as the external objectives of the adjustment program are achieved. The Government intends to apply these restrictions in a flexible manner granting exceptions to the existing limits on requests for foreign exchange for invisible payments abroad in duly authenticated cases. Consultation between the Guatemalan authorities and the Fund is called for before the end of May 1984 to examine the progress made toward liberalization of exchange restrictions with a view toward eliminating the existing restrictions before the expiration of the stand-by arrangement.

New foreign commercial borrowing by the public sector, including public financial institutions, is limited to US$300 million for commitments with maturities of over one year up to and including ten years. During the program period no increase in short-term debt is contemplated.

In the area of exchange rate policy, no adjustment of the parity of the quetzal with the U.S. dollar is expected. Export competitiveness is expected to be improved during the program period by the introduction of a value-added tax (from which exports will be exempt), the elimination of existing export taxes, and the establishment of an export bonus scheme for nontraditional exports sold outside the Central American Common Market.

Guatemala: Selected Economic and Financial Indicators

| | 1980 | 1981 | Est. 1982 | SBA Program 1983 | SBA Program 1984 |
|---|---|---|---|---|---|
| (Annual per cent changes, unless otherwise specified) | | | | | |
| National income and prices | | | | | |
| GDP at constant prices | 3.7 | 0.9 | -3.5 | -2.3 | 1.0 |
| GDP deflator | 10.0 | 8.9 | 6.0 | 7.0 | 7.2 |
| Consumer prices (annual average) | 10.7 | 11.4 | 5.0 | 7.0 | 7.0 |
| External sector (on the basis of U.S. dollars) | | | | | |
| Exports, f.o.b. | 22.4 | -14.5 | -7.6 | -5.0 | 6.6 |
| Imports, c.i.f. | 6.3 | 4.7 | -17.1 | -9.9 | 5.4 |
| Non-oil imports, c.i.f. | -0.9 | 3.6 | -16.3 | -8.3 | 10.8 |
| Export volume | 4.6 | -6.1 | -1.6 | -7.5 | 3.5 |
| Import volume | -9.1 | 1.5 | -14.5 | -11.4 | 1.1 |
| Terms of trade (deterioration -) | 0.1 | -11.8 | -3.2 | 1.0 | -1.2 |
| Nominal effective exchange rate (depreciation -) | 1.6 | 12.1 | 7.6 | ... | ... |
| Real effective exchange rate (depreciation -) | -2.6 | 9.9 | 2.6 | ... | ... |
| Government budget | | | | | |
| Revenue and grants | 11.6 | -0.7 | -1.5 | 2.5 | 20.2 |
| Total expenditure | 31.6 | 23.6 | -17.3 | -4.2 | 10.0 |
| Money and credit | | | | | |
| Domestic credit 1/ | 29.5 | 35.5 | 36.1 2/ | 3.1 | 13.2 |
| Public sector | (18.7) | (25.1) | (14.3) | (10.1) | (7.2) |
| Private sector | (13.9) | (8.4) | (4.9) | (7.0) | (5.3) |
| Money and quasi-money (M2) | 10.1 | 12.7 | 15.1 | -3.7 3/ | 9.4 |
| Velocity (GDP relative to M2) | 4.6 | 4.5 | 4.0 | 4.3 | 4.3 |
| Interest rate (annual rate, time deposits up to 180 days) | 8.0 | 9.5 | 10.0 | 9.0 | 9.0 |
| (In per cent of GDP) | | | | | |
| Overall public sector deficit | 4.4 | 7.1 | 5.1 | 3.6 | 3.0 |
| Central government savings | 1.2 | 0.1 | 0.3 | 0.5 | 1.4 |
| Central government budget deficit | 4.7 | 7.4 | 4.6 | 3.7 | 3.0 |
| Domestic financing | (3.4) | (6.1) | (3.5) | (2.4) | (1.7) |
| Foreign financing | (1.3) | (1.3) | (1.1) | (1.3) | (1.3) |
| Gross domestic investment | 15.9 | 17.3 | 15.8 | 14.3 | 15.9 |
| Gross domestic savings | 13.0 | 10.8 | 12.1 | 12.1 | 13.7 |
| Current account deficit (balance of payments) | 2.2 | 6.5 | 4.2 | 3.2 | 3.0 |
| Public external debt, inclusive of use of Fund credit 4/ | 8.9 | 12.0 | 14.9 | 17.8 | 19.7 |
| (In per cent of exports of goods and services) | | | | | |
| Debt service | 3.8 | 6.1 | 8.5 | 12.6 | 15.8 |
| Interest payments | 1.8 | 2.9 | 3.8 | 6.3 | 7.5 |
| (In millions of U.S. dollars) | | | | | |
| Overall balance of payments | -319 | -349 | -372 | -- | 15 |
| Gross official reserves (months of imports, c.i.f.) | 3.7 | 2.1 | 2.1 | 2.3 | 2.4 |
| Payments arrears | -- | -- | 344 | 350 | 250 |

Sources: Bank of Guatemala; and Fund staff estimates.

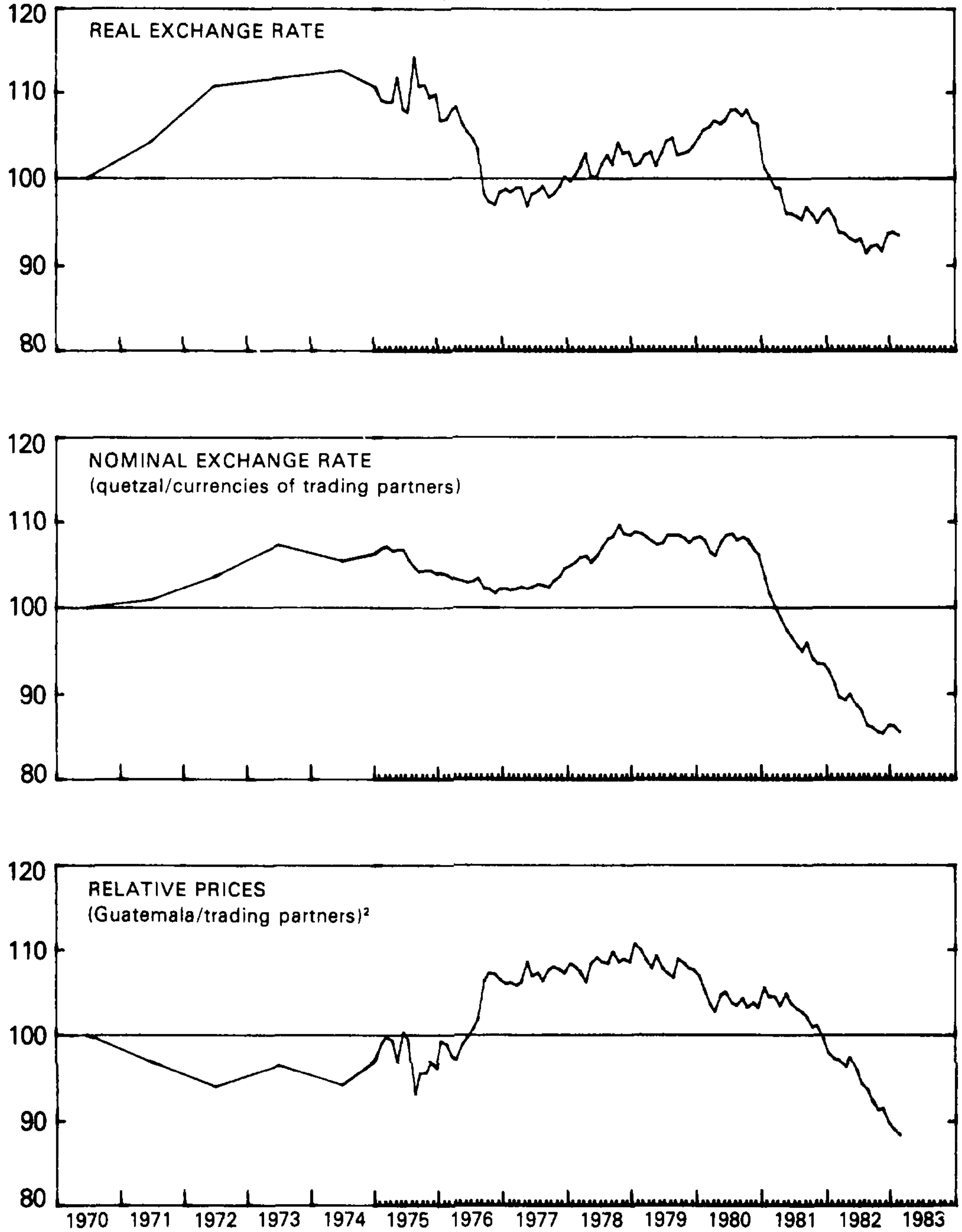
1/ Changes as a proportion of liabilities to the private sector at beginning of the period.
2/ Including the counterpart of payments arrears.
3/ Excluding the counterpart of payments arrears.
4/ Medium- and long-term debt.

CHART 1

GUATEMALA

# EFFECTIVE EXCHANGE RATE, 1970-FEBRUARY 1983[1]

(1970 = 100)




Sources: IMF, *International Financial Statistics;* and Fund staff estimates. From 1970 to 1974 average annual data; from 1975 monthly data.

[1] In Guatemalan quetzales per unit of foreign exchange. The weights are based on the distribution of export and import trade in 1975. Over 96 per cent of trade with partner countries is covered by these weights.

[2] Relative prices were measured by consumer prices indices. For the case of Guatemala, a proxy based on the GDP deflator was used in the period January 1982 - February 1983, because of possible distortions in the consumer price index for those months.

Table 11. Guatemala: National Accounts at Current Prices

(In millions of quetzales)

| | 1980 | 1981 | 1982 | Projected 1983 | Projected 1984 |
|---|---|---|---|---|---|
| Consumption | 6,858 | 7,729 | 7,786 | 8,142 | 8,658 |
| General government | 632 | 706 | 679 | 668 | 737 |
| Private | 6,226 | 7,023 | 7,107 | 7,474 | 7,921 |
| Gross domestic investment | 1,252 | 1,498 | 1,398 | 1,325 | 1,595 |
| Fixed capital formation | 1,295 | 1,442 | 1,306 | 1,250 | 1,495 |
| Public | (463) | (682) | (585) | (432) | (504) |
| Private | (832) | (760) | (721) | (818) | (991) |
| Inventory changes | -43 | 56 | 92 | 75 | 100 |
| Gross domestic expenditure | 8,110 | 9,227 | 9,184 | 9,467 | 10,253 |
| Exports of goods and nonfactor services | 1,722 | 1,460 | 1,307 | 1,225 | 1,285 |
| Imports of goods and nonfactor services | -1,952 | -2,024 | -1,631 | -1,428 | -1,504 |
| GDP at market prices | 7,879 | 8,663 | 8,860 | 9,264 | 10,034 |
| Factor payments abroad | -159 | -165 | -149 | -163 | -165 |
| Factor receipts | 103 | 80 | 34 | 32 | 37 |
| GNP at market prices | 7,824 | 8,578 | 8,745 | 9,133 | 9,906 |
| Indirect taxes net of subsidies | -576 | -540 | -517 | -536 | -551 |
| GNP at factor cost | 7,247 | 8,038 | 8,228 | 8,597 | 9,355 |
| Depreciation | -295 | -330 | -333 | -349 | -379 |
| National income | 6,953 | 7,708 | 7,895 | 8,248 | 8,976 |
| Population (in thousands) 1/ | 7,006 | 7,202 | 7,410 | 7,622 | 7,840 |
| Per capita income (in quetzales) | 992 | 1,070 | 1,065 | 1,082 | 1,145 |

Sources: Bank of Guatemala; and Fund staff estimates.

1/ At midyear; calculated on the basis of the 1964 and 1973 census.

Table 12. Guatemala: Consolidated Operations of the Public Sector 1/

(In millions of quetzales)

| | 1980 | 1981 | 1982 | Projected 1983 | Projected 1984 |
|---|---|---|---|---|---|
| Current revenue | 963.4 | 973.8 | 993.2 | 1,036.6 | 1,223.5 |
| Current account surplus of non-financial public enterprises net of transfers and interest | 41.5 | 36.9 | 62.7 | 94.4 | 109.7 |
| Taxes and other revenue | 921.9 | 936.9 | 930.5 | 942.2 | 1,113.8 |
| Of which: Transfers from: | 30.2 | 45.8 | 54.2 | 6.2 | 15.8 |
| Financial intermediaries | (3.6) | (3.3) | (5.1) | (--) | (--) |
| Private sector | (26.5) | (42.5) | (49.1) | (6.1) | (15.7) |
| Abroad | (0.1) | (--) | (--) | (0.1) | (0.1) |
| Current expenditure | 790.4 | 876.8 | 875.5 | 901.4 | 968.2 |
| Wages and salaries | 450.1 | 494.4 | 488.8 | 498.9 | 555.1 |
| Goods and services | 182.2 | 211.8 | 190.3 | 191.5 | 181.8 |
| Interest | 64.0 | 76.8 | 98.4 | 125.6 | 137.1 |
| Transfers to: | 94.1 | 93.8 | 98.0 | 85.4 | 94.2 |
| Financial intermediaries | (--) | (--) | (--) | (--) | (--) |
| Private sector | (89.2) | (88.7) | (93.3) | (81.8) | (90.3) |
| Abroad | (4.9) | (5.1) | (4.7) | (3.6) | (3.9) |
| Current account surplus | 173.0 | 97.0 | 117.7 | 135.2 | 255.3 |
| Capital receipts | 2.2 | 9.4 | 34.8 | 6.5 | 0.2 |
| Capital expenditure | 497.9 | 692.0 | 590.9 | 446.3 | 522.7 |
| Fixed capital formation | 463.4 | 682.1 | 585.2 2/ | 431.6 | 503.8 |
| Transfers to financial intermediaries | 8.2 | 7.0 | 5.6 | 14.7 | 15.0 |
| Transfers to private sector | 19.8 | -- | -- | -- | -- |
| Other capital expenditure | 6.5 | 2.9 | 0.1 | -- | 3.9 |
| Net lending for reconstruction trust funds | 26.8 | 30.1 | 16.6 | 19.0 | 20.0 |
| Overall deficit (-) | -349.5 | -615.7 | -455.0 | -323.6 | -287.2 |
| Foreign financing (net) | 94.3 | 107.4 | 82.0 | 124.0 | 137.0 |
| Internal financing (net) | 255.2 | 508.3 | 373.0 | 199.6 | 150.2 |

Sources: Ministry of Finance; National Planning Office; Bank of Guatemala; and Fund staff estimates.

1/ All expenditures are on an accrued basis (gastos causados), as there is no breakdown on a cash basis.

2/ These estimates of expenditure differ from those presented in SM/83/76 because of revisions made to reflect the accounting of certain cost overruns for hydroelectric projects of INDE amounting to Q 110.6 million. It has been assumed that 80 per cent of these cost overruns relate to project execution in 1982 with the remainder assigned to 1983. These cost overruns were financed by an increase in floating debt with foreign suppliers.

Table 13. Guatemala: Summary Operations of the Banking System

(In millions of quetzales)

| | Actual December 31 | | | Projected December 31 | |
|---|---|---|---|---|---|
| | 1980 | 1981 | 1982 | 1983 | 1984 |
| **I. Bank of Guatemala and Securities Regulation Fund** | | | | | |
| Net foreign assets | 398 | 49 | -323 | -323 1/ | -308 1/ |
| Net international reserves | 398 | 49 | 21 | 27 | -58 |
| Arrears | -- | -- | -344 1/ | -350 | -250 |
| Net domestic assets | 18 | 387 | 758 | 778 | 811 |
| Public sector (net) | 435 | 880 | 1,136 | 1,376 | 1,542 |
| Banks | -135 | -134 | -317 | -33 | -80 |
| Credits | (130) | (150) | (86) | (287) | (267) |
| Deposits | (-265) | (-284) | (-403) | (-320) | (-347) |
| Medium- and long-term foreign liabilities | -80 | -165 | -240 | -386 | -489 |
| Counterpart arrears | -- | -- | 344 | -- | -- |
| Other | -202 | -194 | -165 | -179 | -162 |
| Currency issue | 416 | 436 | 435 | 455 | 503 |
| **II. Banking System** | | | | | |
| Net foreign assets | 364 | 23 | -351 | -351 | -340 |
| Bank of Guatemala | 398 | 49 | -323 | -323 1/ | -308 1/ |
| Banks | -34 | -26 | -28 | -28 | -32 |
| Net domestic assets | 1,587 | 2,246 | 3,000 | 3,073 | 3,376 |
| Public sector (net) | 480 | 946 | 1,244 | 1,484 | 1,650 |
| Central Government | (512) | (965) | (1,286) | (1,526)2/ | (1,691)2/ |
| Rest of public sector | (-32) | (-19) | (-42) | (-42) | (-41) |
| Credit to private sector | 1,278 | 1,435 | 1,537 | 1,705 | 1,828 |
| Counterpart arrears | -- | -- | 344 | -- | -- |
| Other | -171 | -135 | -125 | -116 | -102 |
| Medium- and long-term foreign liabilities | 92 | 181 | 261 | 417 | 526 |
| Liabilities to private sector | 1,859 | 2,088 | 2,388 | 2,305 | 2,510 |
| Money | 709 | 738 | 749 | 780 | 835 |
| Quasi-money 3/ | 1,150 | 1,350 | 1,639 | 1,525 | 1,675 |

Sources: Bank of Guatemala; and Fund staff estimates.

1/ Consistent with projected balance of payments outcome (Table 5).
2/ Consistent with projected domestic financing requirement of the Central Government (Table 3).
3/ Includes private capital and reserves.

Table 14. Guatemala: Exports by Principal Commodities

(Value in millions of U.S. dollars; volume in thousands of quintals; unit value in U.S. dollars per quintal)

| | 1980 | 1981 | 1982 | Projection 1983 | Projection 1984 |
|---|---|---|---|---|---|
| Coffee | | | | | |
| Value | 463.9 | 325.3 | 374.6 | 346.0 | 334.8 |
| Volume | 2,790.1 | 2,731.1 | 3,324.8 | 3,100.0 | 3,000.0 |
| Unit value | 166.3 | 119.1 | 112.7 | 111.6 | 111.6 |
| Cotton | | | | | |
| Value | 166.1 | 173.4 | 95.0 | 75.4 | 84.0 |
| Volume | 2,935.7 | 2,717.1 | 1,729.0 | 1,300.0 | 1,400.0 |
| Unit value | 56.6 | 63.8 | 55.0 | 58.0 | 60.0 |
| Bananas | | | | | |
| Value | 45.4 | 51.4 | 71.3 | 42.6 | 77.4 |
| Volume | 8,638.1 | 7,697.5 | 7,495.8 | 4,600.0 | 8,600.0 |
| Unit value | 5.3 | 6.7 | 9.5 | 9.3 | 9.0 |
| Sugar | | | | | |
| Value | 69.3 | 85.2 | 43.7 | 64.6 | 66.0 |
| Volume | 4,609.9 | 4,338.2 | 3,988.1 | 6,250.0 | 6,000.0 |
| Unit value | 15.0 | 19.6 | 11.0 | 10.3 | 11.0 |
| Meat | | | | | |
| Value | 29.1 | 29.3 | 16.8 | 21.0 | 30.0 |
| Volume | 241.9 | 283.4 | 173.7 | 210.0 | 300.0 |
| Unit value | 120.2 | 103.4 | 96.7 | 100.0 | 100.0 |
| Petroleum | | | | | |
| Value | 23.7 | 22.1 | 46.1 | 67.9 | 78.0 |
| Volume 1/ | 781.5 | 661.6 | 1,546.0 | 2,425.0 | 3,000.0 |
| Unit value 2/ | 30.4 | 33.4 | 29.8 | 28.0 | 26.0 |
| Cardamom | | | | | |
| Value | 55.6 | 34.3 | 44.2 | 41.9 | 45.5 |
| Volume | 108.8 | 95.8 | 131.0 | 125.0 | 130.0 |
| Unit value | 511.0 | 358.4 | 337.4 | 335.0 | 350.0 |
| Nickel | | | | | |
| Value | 59.1 | -- | -- | -- | -- |
| Volume | 194.9 | -- | -- | -- | -- |
| Unit value | 303.2 | -- | -- | -- | -- |
| Principal exports | 912.2 | 721.0 | 691.7 | 659.4 | 715.7 |
| Other | 607.6 | 578.1 | 507.9 | 480.7 | 499.3 |
| Agricultural products | 104.1 | 102.7 | 90.5 | ... | ... |
| Industrial products | 472.9 | 443.5 | 353.9 | ... | ... |
| Other | 30.6 | 31.9 | 63.5 | ... | ... |
| Total | 1,519.8 | 1,299.1 | 1,199.6 | 1,140.1 | 1,215.0 |

Source: Bank of Guatemala.

1/ In thousands of barrels.
2/ In U.S. dollars per barrel.

Table 15. Guatemala: Medium-Term Outlook

(In millions of U.S. dollars)

| | Actual 1982 | Projected 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|---|
| 1. Balance of payments | | | | | | | |
| Current account | -371 | -297 | -302 | -330 | -338 | -394 | -455 |
| Exports of goods and services | (1,335) | (1,268) | (1,352) | (1,510) | (1,736) | (1,997) | (2,297) |
| Imports of goods and services | (1,771) | (1,602) | (1,699) | (1,900) | (2,149) | (2,471) | (2,842) |
| Of which: Interest payments 1/ | /57/ | /115/ | /132/ | /143/ | /153/ | /158/ | /177/ |
| Transfers | (65) | (37) | (45) | (60) | (75) | (80) | (90) |
| Capital account (net) | -22 | 297 | 317 | 330 | 338 | 394 | 455 |
| Of which: gross borrowings | (320) | (355) | (351) | (415) | (435) | (493) | (529) |
| Overall balance | -393 | -- | 15 | -- | -- | -- | -- |
| Gross reserves (months of imports) | 1.7 | 1.8 | 1.8 | 1.6 | 1.4 | 1.2 | 1.1 |
| Current account deficit/GDP | 4.2 | 3.2 | 3.0 | 3.0 | 2.8 | 2.9 | 3.0 |
| 2. Debt service payments | | | | | | | |
| a. Payments on pre-12/31/82 debt | 107 | 144 | 174 | 214 | 213 | 178 | 145 |
| Interest | (51) | (73) | (77) | (74) | (65) | (58) | (51) |
| Amortization | (56) | (71) | (97) | (140) | (148) | (120) | (94) |
| b. Payments on post-12/31/82 debt | -- | 7 | 26 | 68 | 97 | 128 | 170 |
| Interest | (--) | (7) | (20) | (33) | (51) | (65) | (96) |
| Amortization | (--) | (--) | (6) | (35) | (46) | (63) | (74) |
| c. Payments on IMF purchases | 6 | 9 | 14 | 74 | 84 | 65 | 83 |
| Interest | (6) | (9) | (14) | (22) | (30) | (33) | (30) |
| Amortization | (--) | (--) | (--) | (52) | (54) | (32) | (53) |
| d. Payments on arrears | -- | 76 | 121 | 114 | 107 | 52 | -- |
| Interest | (--) | (26) | (21) | (14) | (7) | (2) | (--) |
| Amortization | (--) | (50) | (100) | (100) | (100) | (50) | (--) |
| e. Total (a+b+c+d) | 113 | 236 | 335 | 470 | 501 | 423 | 398 |
| Interest | (57) | (115) | (132) | (143) | (153) | (158) | (177) |
| Amortization | (56) | (121) | (203) | (327) | (348) | (265) | (221) |
| f. Total excluding arrears (a+b+c) | 113 | 100 | 214 | 356 | 394 | 371 | 398 |
| Interest | (57) | (89) | (111) | (129) | (146) | (156) | (177) |
| Amortization | (56) | (71) | (103) | (227) | (248) | (215) | (221) |
| g. Total excluding arrears and IMF (a+b) | 107 | 151 | 200 | 282 | 310 | 306 | 315 |
| Interest | (51) | (80) | (97) | (107) | (116) | (123) | (147) |
| Amortization | (56) | (71) | (103) | (175) | (194) | (183) | (168) |
| h. Debt service payments/exports *of goods and services* | | | | | | | |
| Total | 8.5 | 18.6 | 24.8 | 31.2 | 28.9 | 21.2 | 17.3 |
| Total excluding arrears | 8.5 | 12.6 | 15.8 | 23.6 | 22.7 | 18.6 | 17.3 |
| Total excluding arrears and IMF | 8.0 | 11.9 | 14.8 | 18.7 | 17.9 | 15.3 | 13.7 |
| 3. Other macroeconomic indicators | | | | | | | |
| Real growth rate | | | | | | | |
| GDP | -3.5 | -2.3 | 1.0 | 2.0 | 3.5 | 5.0 | 5.0 |
| Domestic expenditure | -0.1 | -2.5 | 0.2 | 2.5 | 3.0 | 4.0 | 4.3 |
| Ratio to GDP | | | | | | | |
| Investment | 15.9 | 14.3 | 15.9 | 16.2 | 16.7 | 16.9 | 18.1 |
| Domestic savings | 12.2 | 12.0 | 13.7 | 14.0 | 14.0 | 15.0 | 15.5 |

Sources: Bank of Guatemala; and Fund staff estimates.

1/ On maturities of one year or more.

Stand-By Arrangement - Guatemala

Attached hereto is a letter, dated August 3, 1983, from the Minister of Finance and the President of the Bank of Guatemala requesting a stand-by arrangement and setting forth the objectives and policies that the Government of Guatemala intends to pursue. To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from , 1983 to December 31, 1984, Guatemala will have the right to make purchases from the Fund in an amount equivalent to SDR 114.75 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 12.75 million until October 14, 1983, the equivalent of SDR 25.5 million until December 30, 1983, the equivalent of SDR 38.25 million until March 30, 1984, the equivalent of SDR 57.375 million until June 29, 1984, the equivalent of SDR 76.5 million until September 28, 1984, and the equivalent of SDR 95.625 million until December 28, 1984.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Guatemala's currency in the credit tranches beyond 25 per cent of quota, or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota.

3. Purchases under this stand-by arrangement shall be made from borrowed resources until purchases under this arrangement reach the equivalent of SDR 9,550,000, then each purchase shall be made from ordinary and borrowed resources in the ratio of 2 to 1 until purchases under this arrangement reach the equivalent of SDR 9,587,500 and then each purchase shall be made from ordinary and borrowed resources in the ratio of 1 to 1.2, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Guatemala will not make any purchases under this stand-by arrangement, other than the initial purchase of SDR 12.75 million that it may request not later than within 15 days of the effective date of this arrangement, that would increase the Fund's holdings of Guatemala's currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota:

(a) during any period in which

(i) the limit on the net domestic assets of the Monetary Authority set forth in Table 2 annexed to the attached letter;

(ii) the limit on the net indebtedness of the nonfinancial public sector with the domestic banking system set forth in Table 1 annexed to the attached letter;

(iii) the limit on the outstanding balance of payments arrears set forth in Table 3 annexed to the attached letter; or

(iv) the limits on the amount of new foreign loans contracted by the public sector set forth in paragraph 11 of the attached letter are not observed; or

(b) during any period after January 15, 1984 if the restrictions on invisible payments abroad, excluding nonbusiness travel, have not been eliminated;

(c) during any period after May 31, 1984 if the review contemplated in paragraph 14 of the annexed letter has not been completed or, if further understandings have been reached pursuant to the review, while such understandings are not being observed; or

(d) during the entire period of the stand-by arrangement, if Guatemala:

(i) imposes any new or intensifies any existing restrictions on payments and transfers on current international transactions; or

(ii) introduces multiple currency practices; or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII; or

(iv) introduces or intensifies any existing import restrictions for balance of payments reasons.

When Guatemala is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Guatemala and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Guatemala's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Guatemala. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5,

purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Guatemala and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Guatemala, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. Guatemala will consult the Fund on the timing of purchases involving borrowed resources.

8. Guatemala shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. (a) Guatemala shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Guatemala's balance of payments and reserve position improves.

(b) Any reductions in Guatemala's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the stand-by arrangement Guatemala shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Guatemala or of representatives of Guatemala to the Fund. Guatemala shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Guatemala in achieving the objectives and policies set forth in the attached letter.

11. In accordance with paragraph 16 of the attached letter, Guatemala will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that

consultation on the program is desirable. In addition, after the period of the arrangement and while Guatemala has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Guatemala's balance of payments policies.

Guatemala City, Guatemala
August 3, 1983

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosiere:

1. Since mid-1979, the economic and financial position of Guatemala has deteriorated because of a combination of internal and external factors. The political uncertainty in the Central American region has eroded private confidence which, combined with high interest rates in foreign financial markets in 1980 and 1981, led to large capital outflows. At the same time the effects of the world recession on international commodity prices and foreign demand have weakened Guatemala's export performance. These problems were compounded during 1980 and 1981 by the pursuit of expansionary fiscal and monetary policies designed to offset the recessionary effects of the international and regional economy. The result of these factors was that the net international reserves of the Bank of Guatemala declined by around US$350 million in both 1980 and 1981, while the rate of real economic growth decelerated from about 5 percent in 1978-79 to 1 percent in 1981.

2. During 1982 the Guatemalan authorities implemented an adjustment program which was supported by the Fund with a stand-by arrangement in the first credit tranche. The objective of the program was to limit the overall deficit of the balance of payments to no more than US$50 million as a result of a cutback in the growth of net central bank credit attendant upon a significant reduction in the overall fiscal deficit and an increase in domestic interest rates. Despite a substantial shortfall in revenues, associated with a further decline in exports and domestic economic activity last year, the overall public sector deficit was reduced by around 2-1/2 percent of GDP as a result of sizable cuts in both current and capital expenditures. This expenditure effort reflected a freeze of government salaries, cuts in budgetary authorizations for outlays on goods and services, and a major revision of the public investment program.

3. The overall fiscal deficit was very close to the amount projected, but net bank financing of the public sector exceeded the target in the program last year because of a shortfall in net external financing. Other targets for the banking system were met, however, because of the combination of weak demand for private sector credit and a strong growth in private financial savings. The latter development, nonetheless, reflected to a large extent an accumulation of payments arrears during 1982 estimated at US$344 million, as a result of which

the Bank of Guatemala was able to limit the loss of its net international reserves to the target under the program. The further weakness in the balance of payments last year reflected a large withdrawal of foreign lines of credit as well as the much weaker than projected performance of exports and domestic economic activity.

4. The authorities are determined to continue their adjustment efforts with a view toward stabilizing the balance of payments position of Guatemala over the medium term. To this end the Government has developed a financial program for 1983-84 which is designed to achieve equilibrium in the overall balance of payments, including a substantial reduction in payments arrears. In support of this effort, the Guatemalan authorities would like to request the use of Fund resources under a stand-by arrangement extending through the end of 1984 in an amount equivalent to SDR 114.75 million. The Government's program involves policy commitments in the fiscal, incomes, monetary, external debt, and restrictive fields as detailed in the following paragraphs.

5. In the fiscal area, the aim of the Government is to reduce the overall deficit of the nonfinancial public sector from 5 percent of GDP in 1982 to around 3-1/2 percent in 1983 and 3 percent in 1984, as a result of a combination of revenue and expenditure measures. At the level of the Central Administration, efforts are being made this year to reduce total expenditures in nominal terms for the second consecutive year. This will be achieved by the continuation of an austerity program as regards outlays on goods and services, and a further revision of the public investment program. To ensure that government expenditures will be maintained within acceptable limits in 1984 and beyond, the Government is now instituting procedures for a zero budget operation. As a result of this expenditure policy, central government outlays are targeted at 12 percent of GDP in 1983, compared with 13 percent of GDP in 1982, and 16 percent of GDP in 1981. In 1984 government expenditures will be maintained at the same level in relation to GDP as in 1983.

6. The Government's efforts in the area of expenditure control are being complemented this year by a major tax reform which is designed not only to raise revenue yields, but also to improve the overall efficiency of the tax system. The most important feature of this reform is the substitution of a value added tax (VAT) of 10 percent for the existing cascade-type stamp tax. The VAT was enacted in July 1983 and is expected to yield, on a net basis, additional revenues of Q 58 million in 1983 and Q 199 million in 1984. In addition to allowing for the phasing out of the stamp tax applied to transactions of goods and services, the VAT will facilitate the elimination of numerous outmoded taxes whose yield at present is minimal and probably less than the cost of administering them. In addition, in July 1983 the Government introduced a reform of the income tax which at the corporate level involves a substantial simplification of the existing progressive rate system and the introduction of a new minimum tax on the income of financial institutions. The tax reform also included a change in the base of

selective excise taxes from a specific to an ad valorem basis and other changes in indirect taxes. All in all, the Government's tax package is expected to provide incremental revenue of 1/2 percent of GDP in 1983 and 1-1/2 percent of GDP in 1984.

7. The Government has also been taking steps to improve the performance of the rest of the public sector. Since early last year, the same guidelines on expenditure control which apply to the Central Administration have been extended to all entities of the public sector. In addition, tariffs of the main state enterprises, for example the National Electricity Institute (INDE) and the State Telecommunications Agency (GUATEL), are being adjusted in line with World Bank recommendations in connection with investment programs being financed by that institution. As a result of these measures, the financial position of the rest of the public sector is expected to be in overall balance in 1983 and 1984. Accordingly, the overall deficit of the nonfinancial public sector is targeted at Q 330 million in 1983 and Q 300 million in 1984. In order to monitor performance of the public sector with respect to these targets, the expansion of net credit of the banking system to the nonfinancial public sector will be limited to Q 240 million in 1983 and Q 166 million in 1984, which is compatible with the anticipated foreign borrowing by the public sector. Consistent with these annual projections of bank credit expansion to the public sector, quarterly ceilings on the net indebtedness of the nonfinancial public sector with the domestic banking system have been established through December 1984, as specified in Table 1.

8. During the program period, it is expected that domestic wages and prices will continue to reflect essentially the interplay of market forces. Accordingly, the scope of price controls has been reduced by the Government, and these are being maintained only for essential consumer goods and medicines. Also, these controls will be administered flexibly to preclude the emergence of distortions. Minimum wage levels in the private sector are established by the Government, but otherwise the authorities do not intervene in the wage determination process, except as a mediator in collective bargaining procedures. The Government believes that during the program period wage adjustments will be compatible with the maintenance of relative price stability.

9. Monetary policy will be guided by the objective of achieving equilibrium in the overall balance of payments in 1983 and a small overall surplus in 1984 and maintaining a rate of domestic price inflation in line with that of Guatemala's trading partners abroad. Such a result will be facilitated by the strengthening of the financial position of the public sector which should lower its dependence upon domestic bank credit. In conformity with the objectives of the monetary program, the net domestic assets of the monetary authority are programed to increase by not more than Q 20 million during 1983 and by not more than Q 33 million during 1984. Quarterly ceilings for the net domestic assets of the monetary authority have been established through December 1984, as indicated in Table 2, which are consistent with those indicated in Table 1 for the bank credit to the public sector.

10. In order to facilitate the objectives of the monetary program, the Government intends to pursue a realistic interest rate policy. In November 1982 the ceilings on domestic interest rates were reduced to 12 percent (for loans) and to 9 percent (for deposits) in line with a marked deceleration in the rate of domestic price inflation and a decline in interest rates in foreign financial markets. These ceilings will be reviewed periodically to ensure that domestic interest rates are generally positive in real terms and competitive with those abroad. In addition, the Government has improved the structure of domestic interest rates by eliminating the application of the stamp tax to bank credits in the context of the tax reform described earlier. Also, the authorities are studying the means of introducing more flexibility into the interest rate system.

11. Consistent with the fiscal and monetary program described above, the Government intends to use foreign credit to finance productive investment projects in the public sector and to complement domestic financial savings in the extension of credit through the domestic banking system to the private sector for productive activities. Nevertheless the Government intends to continue its prudent policy of foreign borrowing in order to maintain its favorable external debt profile over the medium term. Accordingly, the contracting by the public sector, including public financial institutions, of new foreign commercial loans with maturities of over one year up to and including ten years will be limited to US$300 million during the period of the program. Within this overall ceiling, new commitments with maturities of over one year up to and including five years will be limited to US$150 million. These ceilings will also apply to private sector loans and suppliers' credits with official guarantee, but will exclude any new loans related to the rescheduling of external payments arrears and credits under the Mexico-Venezuela oil facility. The Government also intends to ensure that the outstanding stock of short-term foreign indebtedness by the nonfinancial public sector as of December 1982 will not increase during the program period.

12. The balance of payments objective of the Government's financial program includes a substantial reduction of external payments arrears. Specifically, these arrears will be reduced by US$50 million during 1983 and by US$100 million during 1984. Consistent with these annual targets, quarterly limits on the outstanding stock of external payments arrears in the Bank of Guatemala have been established, as indicated in Table 3. In order to monitor the performance with respect to these limits, all payments arrears accumulated prior to the date of this letter will be fully backed by a 100 percent local counterpart deposit in the Bank of Guatemala. To monitor the emergence of any arrears in the future, the authorities will require that all applications for foreign exchange purchases be backed by counterpart deposits in local currency equivalent to 100 percent of the amount requested. All deposits against payments arrears, both old and new, will be blocked in a special account of the Bank of Guatemala.

13. The Government believes that a policy of export promotion and import substitution is a key element of its medium-term development strategy. To this effect, the Government has introduced a number of tax incentives for the export sector which are designed to yield positive benefits for the external sector over the next few years. In September 1982, the Government revised the coverage and application of the drawback law, by which exporters are reimbursed for import duties on inputs used in the production of their exports to countries outside the Central American Common Market (CACM). In addition, the Government has introduced, in the context of the tax reform mentioned earlier, an export bonus scheme (CATs) which will apply to the value of new, non-traditional exports. Also, the Government's tax reform includes a reduction of export taxes to improve the profitability of existing exports. In regard to tariff policy, the Government is now in the process of reviewing together with other CACM members the common external tariff of the region with a view to reducing the dispersion of tariff rates and altering the structure of protection for local industry. Finally in the area of import substitution, the Government will be reducing significantly the cost of imported fuel in 1983 and beyond with the coming on stream of the Aguacapa and Chixoy hydroelectric plants.

14. Guatemala's exchange system has traditionally been free of restrictions on payments and transfers for current international transactions. In April 1980 exchange controls were established to restrict private capital transactions and transfers of capital disguised as current transactions. Among other things, limits were established on exchange requests for certain invisible payments abroad, which were reduced in September 1981 and again, in the case of travel, in November 1982. At the same time, quotas on imports requiring payments with foreign exchange requested from the Bank of Guatemala were established. These restrictions are temporary measures and will be eliminated as the external objectives of the Government's adjustment program are achieved. Moreover, the Government intends to apply the limits on invisible transactions in a flexible manner whereby exceptions to the existing limits will be granted in duly authenticated cases. The authorities will consult with the Fund before May 31, 1984 with a view toward eliminating the remaining exchange restrictions before the expiration of the stand-by arrangement.

15. During the period of the program, the Government of Guatemala does not intend to introduce any multiple currency practice, impose any new or intensify any existing restrictions on payments or transfers for current international transactions, conclude any bilateral payments agreement which is inconsistent with Article VIII of the Fund Agreement, or introduce any new or intensify any existing restrictions on imports for balance of payments reasons.

16. The Government believes that the policies set forth in this letter are adequate to achieve the objectives of the program, but will take any further measures that may become appropriate for this purpose. The Government will consult with the Fund on the adoption of any measures that may be appropriate, in accordance with the policies of the Fund on such consultation. Progress made in the implementation of the program will be reviewed with the Fund before May 31, 1984.

Sincerely yours,

Leonardo Figueroa Villate
Minister of Finance

Armando Gonzalez Campo
President
Bank of Guatemala

Table 1. Guatemala: Ceilings on the Net Indebtedness of the Nonfinancial Public Sector with the Domestic Banking System 1/

(Outstanding balances in millions of quetzales)

| Period | Ceiling |
|---|---|
| July 1, 1983 - September 30, 1983 | 1,405 |
| October 1, 1983 - December 31, 1983 | 1,485 |
| January 1, 1984 - March 31, 1984 | 1,515 |
| April 1, 1984 - June 30, 1984 | 1,545 |
| July 1, 1984 - September 30, 1984 | 1,585 |
| October 1, 1984 - December 31, 1984 | 1,655 |

1/ These ceilings will be adjusted upwards to take account of any increase in government bond holdings by the Bank of Guatemala related to external debt service payments of DAG by the Bank of Guatemala through February 1983 in an amount of up to Q 38 million.

Table 2. Guatemala: Ceilings on the Net Domestic Assets of the Monetary Authority 1/

(Outstanding balances in millions of quetzales)

| Period | Ceiling |
|---|---|
| July 1, 1983 - September 30, 1983 | 775 |
| October 1, 1983 - December 31, 1983 | 780 |
| January 1, 1984 - March 31, 1984 | 775 |
| April 1, 1984 - June 30, 1984 | 770 |
| July 1, 1984 - September 30, 1984 | 775 |
| October 1, 1984 - December 31, 1984 | 810 |

1/ Adjusted downwards for any difference between actual and projected level of arrears as shown in Table 3.

Table 3. Guatemala: Limits on the Outstanding Balance of Payments Arrears 1/

(In millions of quetzales)

| Period | Limit |
|---|---|
| July 1, 1983 - September 30, 1983 | 400 |
| September 1, 1983 - September 30, 1983 | 385 |
| October 1, 1983 - December 31, 1983 | 350 |
| January 1, 1984 - March 31, 1984 | 325 |
| April 1, 1984 - June 30, 1984 | 300 |
| July 1, 1984 - September 30, 1984 | 275 |
| October 1, 1984 - December 31, 1984 | 250 |

1/ Adjusted downwards for difference between projected and actual level of arrears outstanding as of August 31, 1983, and adjusted upwards for any of that same difference which is converted into bonds after Augut 31, 1983 until December 31, 1983.