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May 6, 1998

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Guatemala—Staff Report for the 1998 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 1998 Article IV consultation with Guatemala, which is tentatively scheduled for discussion on Wednesday, May 27, 1998.

Mr. Cardemil (ext. 38503) or Mrs. Da Costa (ext. 34326) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Thursday, May 14, 1998; and to the European Commission (EC), the European Investment Bank (EIB), and the Inter-American Development Bank (IDB), following its consideration by the Executive Board.

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GUATEMALA

Staff Report for the 1998 Article IV Consultation

Prepared by the Staff Representatives for
the 1998 Consultation with Guatemala

Approved by Claudio M. Loser and John Hicklin

May 5, 1998

- Discussions for the 1998 Article IV consultation were held in Guatemala during November 10–21, 1997, and in Washington D.C. during December 9–16, 1997, and February 2–3 and 17–18, 1998.
- The staff team comprised Messrs. Cardemil (Head), Espejo, La Pittus, and Lim, and Mrs. Da Costa (all WHD). Messrs. Toribio and Rodríguez, Executive Director and Advisor to Executive Director for Guatemala, respectively, participated in the discussions in Washington.
- The mission met the Finance Minister, the President of the Central Bank, the Minister of Economy, the Chairman of the Assembly's Finance Committee, and other senior officials, as well as representatives of the private sector and academics. The staff also had discussions with representatives of the independent Peace Commission (*comisión de acompañamiento*) established to oversee implementation of the peace accords. The mission coordinated its work closely with the UN Verification Mission in Guatemala (MINUGUA), as well as with the staff of the World Bank, IDB, and UNDP.
- Guatemala is on the standard 12-month cycle and has accepted the obligations of Article VIII, Sections 2, 3, and 4. Fund, IBRD, and IDB relations are summarized in Attachments I, II, and III.

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EXECUTIVE SUMMARY

- Over the past three years **macroeconomic conditions have improved**. The fiscal and balance of payments positions have strengthened considerably, inflation has declined to single digits, and growth has been maintained at about 4 percent. Since the signing of the peace accords in 1996 progress has been made in reducing the influence of the military and the peaceful reinsertion of insurgents into the political process. However, social programs have moved slowly, and serious problems of poverty and inequality persist.
- **Efforts to raise tax revenue to fund increased social spending, as called for by the peace accords, remain elusive.** In December 1997 congress approved a package that would raise the tax ratio to 9.2 percent of GDP in 1998 (8.8 percent in 1997), but because some of the measures were temporary, the ratio would fall back to about 8.7–9.0 percent in 1999–2000. This compares with the 12 percent of GDP target of the peace accords. The authorities believe that it would be difficult to adopt new tax measures in 1998, but they have not ruled them out on the 1999 budget. The **Peace Commission** overseeing implementation of the peace accords is to discuss tax options with the authorities within a new schedule to achieve the original revenue targets over an extended time period.
- **The authorities' program for 1998** would step up new peace related expenditures while limiting the fiscal deficit to 1 percent of GDP, financed with external aid; international reserves are to be maintained at three months of imports and inflation at 6 to 8 percent. Output growth is projected to rise to 4.5 percent. **Prospects for 1999 and the medium term** would depend on whether tax policy is strengthened; declining revenue would risk raising the fiscal deficit or, more likely, reverse progress in the social programs. Efforts are being made at improving tax compliance but significant results would take a few years.
- **Credit policy** is being tightened in 1998, and the central bank plans to reactivate open market operations (following a sharp decline in net placements in 1997) while allowing interest rates to increase, as needed, to offset demand pressures. Increased open market placements also would facilitate the reduction of high reserve requirements, which would help reduce spreads and strengthen financial intermediation. On **exchange rate policy**, the authorities have discontinued recent heavy intervention to stem downward pressures on the currency, and they intend to allow the rate to reflect market conditions while intervening only to smooth out large fluctuations.
- In the **structural area**, plans are to advance public sector modernization and privatization; the program for 1998 calls for divestment of telephone and power distribution. **Financial sector reform**, supported by an IDB sector loan, is to focus on modifying the outdated legal framework to strengthen substantially bank supervision (which does not currently meet the Basle Core Principles), prudential norms and the process of effectively dealing with problem institutions. A thorough diagnosis of the balance sheet position of financial institutions should be completed promptly to identify problem institutions.

I. INTRODUCTION

1. Since early 1997, following the signing of the U.N. sponsored peace accords that ended Guatemala's civil conflict, the staff has maintained discussions with the authorities on a possible Fund-supported program aimed at consolidating macroeconomic stability in a framework of increased public sector expenditures to advance the social and institutional objectives of the accords. These discussions were intensified following the Managing Director's visit to Guatemala in May 1997. However, as the authorities are still working on key policies to be included in their program, management has not yet been in a position to bring it for the consideration of the Executive Board.
2. At the meeting for the last Article IV consultation on October 16, 1996 (EBM/96/94; SM/96/247),¹ Directors viewed the end of the internal conflict as an opportunity to consolidate improved economic conditions while addressing deep-rooted social problems. They expressed the view that Guatemala's low tax effort hindered the government's ability to increase social outlays and felt that there was scope to strengthen direct and indirect taxation. Directors stressed the importance of pursuing a cautious credit stance and urged the authorities to press on with the privatization and financial modernization programs.
3. Guatemala's statistical information permits reasonable monitoring of economic and financial developments. However, important deficiencies remain on national accounts and in the recording and time lag of information on public sector revenue and expenditure. Some of these problems are being addressed, including with the help of STA (Appendix IV).

II. BACKGROUND

A. Social and Political Situation

4. Despite some progress in social conditions since the early 1990s, Guatemala continues to face serious problems of **poverty and income inequality**. Three fourths of the population live below the poverty line and poor infrastructure contributes to keeping large segments of the population isolated and outside the formal market economy. Government social expenditures as well as the tax effort are among the lowest in Latin America. Political strife led to a 36-year guerrilla warfare, mostly during periods of repressive military regimes. After a decade of negotiations, in December 1996 the government and former insurgents (*Unión Revolucionaria Nacional Guatemalteca, URNG*) signed the peace accords under the aegis of the United Nations.

¹The 1997 Article IV consultation had been expected to be brought to the Board with a request for a stand-by arrangement. The consultation was postponed as progress on the program negotiations stalled after legislation during December–February reversed agreed policies.

5. In early 1997 the administration of President Arzú outlined a **peace program** covering the period through 2000, that was to include: (i) strengthening of the democratic institutions, the judicial system, and public security; (ii) higher spending on basic infrastructure, health and education, and low income housing; and (iii) the development of rural indigenous communities. Higher spending was to be funded with an increase in the tax effort from the current 8½ percent of GDP to 12 percent by 2000. The program received strong support at a Consultative Group meeting in January 1997.

6. Implementation of the peace program has been mixed. Significant progress has been made in reducing the influence of the military (including a reduction in troops, closing of military zones, and the conversion of military institutions into civilian agencies), building a new civilian police, and consolidating the peaceful reinsertion of former combatants in the political process. However, the government's social program has moved at a slower than anticipated pace because of problems of implementation capacity and lagging mobilization of resources. Since mid-1997 the political situation has been complicated by an increasing wave of serious crime (including kidnaping and assaults on foreigners) in the cities and rural areas, which has raised concerns about the government's ability to improve public security and may erode the increased confidence that followed the signing of the peace accords.

7. The term of President Arzú's administration ends in January 2000, and presidential and congressional elections are to be held in November 1999. Municipal elections are slated for June 1998, which would be followed by the start of the presidential campaign. The ruling party (Avanzada Nacional—PAN) holds more than half of the seats in the National Assembly.

B. Economic Developments

8. Over the past three years macroeconomic conditions have improved in response to prudent monetary and fiscal policies and earlier advances made on exchange and trade liberalization and financial sector reform. The overall fiscal position has been brought to near balance, the external current account deficit has been cut to about 3½ percent of GDP, and net international reserves have strengthened considerably. Output has been expanding by about 4 percent a year for most of the 1990s, mainly on the strength of agricultural exports and private sector commerce and services. In 1996 output growth fell to 3 percent as domestic demand slowed with the sharp decline in international coffee prices, but economic activity began to recover in the closing months of the year. In 1997 real GDP is estimated to have risen by more than 4 percent, with an increase in private investment. After rising to 11 percent in December 1996, reflecting mostly an adjustment in the VAT rate, the 12-month inflation rate fell to 7 percent in December 1997 and 6.7 percent in March 1998.

9. In the **public finances**, since 1994 the authorities have attempted to raise the tax effort on a lasting basis to achieve fiscal consolidation while increasing social spending and public investment. Despite strong opposition to higher taxes, in 1995–96 the government did succeed in raising the VAT rate from 7 to 10 percent and introducing a temporary tax on gross income, which raised the tax ratio by 2 percentage points of GDP to 8.7 percent in 1996. Higher revenue combined with tight expenditures shifted the **combined public sector**

position from a deficit of 2.3 percent of GDP in 1994 to balance in 1996. In 1997 the tax ratio remained at 8.8 percent of GDP, while government social expenditure increased by nearly 1 percentage point of GDP to 5 percent. The overall fiscal deficit was limited to 0.5 percent of GDP, because of lower interest payments on the public debt and a decline in the operating losses of the central bank. External financing of the public sector rose in 1997, which helped to retire high-cost short-term domestic debt and to accumulate a further sizeable amount of deposits with the central bank.

10. The fiscal improvement in 1996–97, together with increased official external financing and private inflows, contributed to a **strong increase in net international reserves** (in December 1997 the NIR rose to 24 percent of M2 and gross reserves to 3.1 months of imports). With an improved reserve position, in late 1996 the central bank moved to ease credit conditions. It suspended new open market placements and did not roll over obligations as they matured. Net redemptions of paper accelerated beginning in the second quarter of 1997 and by January 1998 the stock of these obligations with the private sector had been virtually eliminated. This contributed to a reduction in central bank losses from 1.2 percent of GDP in 1996 to 0.8 percent in 1997.

11. The reduction of the public sector short-term debt and the decline in inflation led to a significant **fall in domestic interest rates** during 1997 (interest rates on six-month treasury bills fell to 10–11 percent, from 18–20 percent in 1996) and to an acceleration in the growth of bank credit to the private sector to 20 percent in 1997, from 10 percent in 1996. At the same time, the growth of private sector financial assets (private claims on banks and holdings of government paper) slowed beginning in mid-1997 to a 12-month rate of 13 percent by year end, from 17 percent in December 1996.

12. To reduce intermediation spreads, in December 1997 the Monetary Board approved a reduction of banks' legal reserve requirements in monthly steps over six months (from an effective rate of 24 percent of banks' deposit liabilities to 19.6 percent by June 1998), while extending application of reserve requirements to certain previously exempted deposit liabilities. The net monetary impact of this action is estimated to be moderately expansionary, and the Board authorized to offset such an impact, as needed, with open market operations. Also in February 1998 the Monetary Board authorized commercial banks to offer deposits and loans denominated in foreign currency. Specific norms and regulations still need to be established by the Superintendency of Banks.

13. After averaging 6 percent of GDP in 1992–94, the **external current account deficit** fell to 4 percent of GDP in 1995 and 2.8 percent in 1996, on the strength of nontraditional exports and private remittances, while import growth moderated. In 1997, the current account deficit is estimated to have risen to 3.5 percent of GDP because of a higher trade deficit. Exports grew by 16 percent (in U.S. dollars), aided by an increase in coffee prices and a continuing strong performance of nontraditional exports, while import growth accelerated to 21 percent, with a particularly sharp increase in the second half of the year. With higher net inflows of private capital the overall balance of payments shifted into a large surplus in 1996. An even larger overall surplus was recorded in 1997 (US\$290 million, or 1.6 percent of GDP)

with an increase in official capital, including the placement of US\$150 million in long-term bonds in international markets; strong private sector inflows continued in the first half of 1997 but subsided in the second half as domestic interest rates declined.

14. With higher capital inflows there were upward pressures on the quetzal in 1996 and the first half of 1997, and the central bank intervened in the interbank foreign exchange market to slow the appreciation of the currency. In the second half of 1997, however, the slowdown in private inflows and the more rapid growth of bank credit and imports put downward pressure on the currency, which prompted the central bank to sell foreign exchange. Central bank net sales of foreign exchange rose sharply in January 1998 (to about US\$120 million), but were discontinued in February, as the exchange rate stabilized. In real effective terms the quetzal appreciated by 7.6 percent in 1996 and by a further 7.2 percent during the first half of 1997, but remained unchanged during the second half of 1997 and the first quarter of 1998.

15. In the **structural area**, in November 1996 the General Electricity Law and the Telecommunications Law were enacted, providing the legal framework for private sector participation in these sectors. The electricity law also establishes mechanisms for power rate adjustments, which had not been implemented for several years owing to court challenges. In April 1997 the commission raised the maximum rates for residential consumers by 50 percent, or to about the levels that would cover long-term marginal costs. To facilitate privatization, in August 1997 EEGSA (a state power distribution enterprise serving Guatemala City) sold its generation plants, and in November 1997 the major state-owned power company (INDE) was separated into three enterprises with responsibilities for generation, transmission and distribution. Within the new legal framework on telecommunications, a bidding process was opened to sell the telephone company (TELGUA). However, in December 1997 the government decided to reject a single offer by an international telephone company, as the bidding price was considered to be below the value of the company. A new bidding process for the shares of TELGUA (up to 95 percent of the shares) was initiated in February 1998, which the authorities expect to conclude sometime early in the second half of 1998.

16. In February 1998, the Assembly approved the **Foreign Investment Act**, eliminating a number of institutional impediments and discriminations against foreign investment (including on tax laws). The new law, to be enforced by the Ministry of Economy, opens most economic sectors to foreign investment and limits government expropriation rights.

III. POLICY DISCUSSIONS

17. Discussions with the authorities centered on the outlook and policies for 1998 and 1999 in the context of a medium-term program. A key element of the program would be the mobilization of domestic resources, which together with an increase in official external aid, would fund new peace-related expenditures. The discussions focused, particularly, on

measures to strengthen tax policy and administration,² and expenditure policies to give more emphasis to the social sectors. Resistance to increased taxation has remained strong, however, because of a lack of political consensus, with business groups opposing higher direct taxes and labor groups resisting adjustment in indirect taxes.

18. The difficulties of raising revenue to the levels envisaged in the original peace program (an increase in the tax ratio by 3½ percentage points of GDP to 12 percent by 2000) led the authorities to revise their plans and aim to achieve the same revenue objectives over an extended time period (Table 1). In November 1997, the government submitted to congress a tax package, which although less ambitious than what would have been required to reach the targets of the peace accords, was to provide the basis for a sustained upward trend in government revenue. A program with revised fiscal targets was agreed with the staff on a preliminary basis, while the authorities were to seek the consent of the independent **peace commission** to extend the timetable for the revenue targets.³ However, in December 1997 and February 1998, the Assembly weakened the tax package substantially.⁴ As it now stands, the tax ratio is projected to increase from 8.8 percent of GDP in 1997 to 9.2 percent in 1998, but because of the lapse of temporary measures, it would fall back in 1999 and 2000.

Table 1. Tax Revenue Targets

	(Percent of GDP)			
	1998	1999	2000	2002
Original Peace Program	10	11½	12	12
Authorities revised program	9.2	10	10½–11	12
Projected revenue with no additional action	9.2	8.7	8½–9	...

²Following the Managing Director's trip to Guatemala in May 1997, the staff has had a number of discussions on the tax issue with business, labor, and congressional leaders, in an attempt to help the authorities reach a consensus on a balanced tax package.

³The peace commission (*comisión de acompañamiento*) which oversees implementation of the peace accords, comprises representatives from a wide spectrum of the society, including representatives of the Assembly and former insurgent groups, and includes the Chief of the U.N. Verification Mission (MINUGUA), which acts as a guarantor of the peace accords.

⁴A minimum gross income tax on corporations was made to lapse in May 1999, diesel and other items were excluded from a fuel tax increase, and a land tax approved in the original package, was subsequently repealed.

19. In a meeting with President Arzú in February, the peace commission expressed concern regarding the prospects for declining tax revenue after 1998 and the implication that this may have for the social undertakings of the peace accords. Concerns over weak revenue efforts also were highlighted in a recent report of the U.N. Secretary General on the implementation of the peace accords, and bilateral donors have continued to encourage the government to fulfill its pledge on revenue. In part responding to these pressures, the authorities recently indicated to the staff that while it would be politically difficult to implement new tax measures during 1998, they have not ruled out acting on tax legislation that could be effective with the 1999 budget. They expected that the peace commission would approve the revised fiscal schedule, and said that meetings were being scheduled with the commission to discuss tax options aimed at achieving the new revenue targets.

A. The Macroeconomic Outlook

20. In discussing the **prospects for 1998**, the authorities said that with the rise in revenue and the external flows currently projected they could step up implementation of the social spending while consolidating macroeconomic stability and advancing structural reform. They expressed their intention to gear their policies toward maintaining gross international reserves at three months of imports, while targeting inflation to 6 to 8 percent in 1998. Output growth is projected to rise to about 4½ percent in 1998, on the strength of agricultural output and a moderate increase in domestic investment.

21. The **prospects for 1999 and beyond**, however, would depend on whether the authorities can strengthen tax policy to achieve the steady increase in revenue that their fiscal program calls for. The prospective weakening in the tax effort in 1999, if left to stand, likely would be further aggravated by a decline in official aid with adverse effects on the continuing implementation of the social program and the peace accords, as well as on the prospects for higher growth over the medium term. In contrast, the prospects for reaching the growth objectives of the peace accords of 6 percent or higher would be greatly strengthened with the sustained implementation of social programs that would help over the medium to longer term achieve gains in human capital and productivity as well as help integrate the large rural indigenous population into the mainstream market economy. It is therefore essential that the authorities and the peace commission find ways to strengthen tax policy in 1999 and beyond to maintain open the opportunities presented by the peace accords.

B. Fiscal Policy

22. The authorities' fiscal program over the next two years calls for the acceleration in implementation of the social and institutional expenditures of the peace accords, **within a sound fiscal framework**. Peace-related spending is projected to rise by 1½ percentage points of GDP (to some 6½ percent) in 1998 and—on the basis of a steady increase in revenue and continuing aid flow disbursements—by a further 2 percentage points of GDP by 2000. Under these plans, the deficit of the combined public sector would rise to 1 percent of GDP in 1998 and to around 1½–2 percent in 1999–2000. The authorities do not plan to use domestic bank

financing, as they expect these deficits to be covered with the available external flows from bilateral and multilateral sources.

23. While the 1998 fiscal targets appear to be achievable, the room for raising social spending in subsequent years would be narrowed substantially in the absence of tax measures that would maintain the trend of higher revenue. Without a determined tax effort, the aid that has been pledged is likely to be reduced, and the fiscal deficit would thus need to be scaled down if the authorities' macroeconomic objectives are to be attained. Table 2 illustrates these alternative scenarios in which the deficits have been estimated on the basis of no recourse to domestic financing. Conceivably, the government could maintain temporarily a higher deficit by increasing foreign commercial borrowing. Higher commercial borrowing, however, would be unlikely to replace the large official aid that had been pledged, and probably would come at a higher cost. The use of the expected privatization proceeds also is an option to finance temporarily a higher deficit, but the authorities have indicated that they would resist pressures to take such a course as it would interrupt the government plans for central bank recapitalization and reduction in high cost short-term debt.

Table 2. Public Sector Deficit and Social Expenditure Under Two Scenarios
(Percent of GDP)

	1998	1999		2000	
		A	B	A	B
Central government					
Tax Revenue	9.2	10.0	8.7	10.7	8.8
Social expenditure	6.6	7.9	5.9	8.8	6.2
Combined public sector balance	-1.1	-1.6	-1.0	-1.5	-0.8
Net external financing	1.4	1.6	1.0	1.5	0.8

A. Program with increasing tax revenue; B. No additional tax measures.

24. With regard to revenue, the Minister of Finance believes that based on improvements in tax administration over the next two years, the tax ratio—in the absence of additional measures—could be between ½ and 1 percentage point of GDP higher than estimated by the staff, and thus it might be feasible to avoid a decline in 1999. However, in early 1997 FAD assessed tax administration in Guatemala as very weak and made a number of recommendations, including changes in legislation. The authorities are acting on several of such recommendations, including the recent approval of legislation that would permit the creation of the Superintendency of Tax Administration (SAT). With a further strengthened tax code that would facilitate application of sanctions, the SAT could become an important instrument to improve tax compliance over time. It would thus be important to speed up the operations of the SAT, which under current schedule are not expected before 1999, as recent experience in

Guatemala indicates that significant revenue improvement due to tax administration could only be expected over several years.

25. Even assuming that some improvement in revenue collection is realized with the operation of the SAT, new tax measures would be required to achieve the target of 10 percent of GDP in 1999, and still further action for the goal of 12 percent of GDP in 2002. While the tax system should be modified substantially with base-broadening measures to enhance efficiency and buoyancy (Box 1), options that could be considered in the near term include (i) the extension beyond mid-1999 of the minimum gross income tax on corporations; (ii) a further increase in fuel consumption tax (taking opportunity of the low international petroleum prices); and (iii) a postponement in the scheduled reduction of income tax rates (maximum rates are scheduled to be reduced from 30 percent to 25 percent during 1998–2000). An increase in the VAT rate (from 10 to 13 percent), which would yield 1 percent of GDP annually, has been ruled out for 1998, but it likely would be part of a future package to eventually reach the target of 12 percent of GDP.

26. Overall **government expenditures** are projected to rise by 1½ percent of GDP to 11½ percent in 1998. This entire increase would be directed to peace-related spending, which is to concentrate, in the social area, on primary health and education, and programs of poverty alleviation and rural development; and in the institutional area, on the strengthening of the judicial system and public security (Box 2). Efforts are being made to reduce the cost of social services through competitive procurement practices, but more needs to be done regarding the **quality and targeting of services**, including through improvements in community-based education and health programs.

27. Efforts are being made to **reduce unproductive spending**. As part of the demobilization under the peace accords, the defense ministry reduced the number of troops, but savings resulting from this action would be largely offset by costs associated with the new civilian police and higher purchases of goods and services, after several years of frozen appropriations. Regarding wages, general civil service compensations were adjusted in April 1997 and January 1998 by a cumulative 20 percent, following only partial adjustments since 1992. The authorities said that they intended to maintain a cautious policy on wages, but did not rule out a further increase in early 1999.

C. Monetary Policy

28. With the prospective higher fiscal deficit in 1998, the authorities are fully aware of the need to tighten credit policy if inflation is to be kept in check and the international reserve position maintained at an adequate level. In order to tighten credit conditions the central bank would need to reactivate its open market operations as the main instrument of monetary control. During most of 1997 the central bank made net redemptions of paper as the government accumulated large deposits. Projections for 1998, however, suggest that the government would contribute little to absorb liquidity, and the authorities would need to stand ready to neutralize any demand pressures that could arise from the anticipated increase in deficit spending. This may result in some increase in interest rates, and the authorities' monetary

Box 1. Reform of the Tax System

Guatemala's tax system is characterized by : (i) low tax rates, (ii) a narrow base because of wide exemptions and deductions (granted by the Constitution, or special laws), and (iii) a weak legal and regulatory framework to enforce tax compliance. Many changes have been made to the tax system over the past thirty years, which were not of a permanent character, and as a result the average tax ratio has remained at around 8 percent. Several measures were introduced in 1995-96, including the increase in the VAT rate from 7 percent to 10 percent and a temporary tax on gross assets, which raised the tax ratio from 6.8 percent in 1994 to 8.6 percent in 1996.

Tax Measures Introduced in 1997-98:

- **In March 1997** the Assembly approved **changes to the income tax law**, including: (i) as **tax increases**, an expansion in the coverage affected by tax withholdings, and a reduction in the period to carry over losses to two years; and (ii) as **tax reductions**, a three-step drop in the maximum income tax rate from 30 percent to 25 percent by mid 2000, an increase in the minimum personal income exempted and in the maximum VAT credit against income tax liabilities to individuals. The net effect of these income tax increases and reductions is estimated to be about zero by 2000.

- **In November 1997** the government **submitted a tax package** to the Assembly including: (i) a 1¼ percent **tax on gross income** or 2½ percent on **gross assets** (IEMA), credited against the income tax with a one-year lag; (ii) an **increase in the tax on consumption of petroleum derivatives** (about US\$0.17 per gallon), **air, sea and land departure**, and **beverages**; (iii) a **land tax**; and (iv) the **elimination of certain specific laws** establishing exemptions and preferential treatments in the VAT, income tax and import tariffs. In the **package approved by the Assembly** the gross income tax was made to lapse in May 1999, diesel and other items were excluded from the fuel tax, and the land tax was repealed.

- **In January 1998** the Assembly approved legislation authorizing the creation of the **Superintendency of Tax Administration (SAT)**. The new agency would operate as an autonomous agency covering the functions of the present internal revenue and customs agencies. The SAT would need to hire and train new personnel and the authorities expect the agency to be operational in early 1999.

Actions Needed to Improve the Tax System on a Permanent Basis:

Technical assistance missions by FAD and the World Bank have emphasized a reform that would: (i) strengthen direct and indirect taxation with the lowest distortionary effect on resource allocation; (ii) concentrate on very few taxes easy to collect and administer; (iii) have a minimum amount of deductions and exemptions to minimize erosion of the base and evasion; (iv) strengthen tax administration with a clear and simple regulatory framework for the application of sanctions. On these basis, the staff has recommended:

1. **VAT:** (i) increase the rate by at least 3 percentage points; (ii) eliminate most exemptions and zero rate regimes and tax credit refunds, except for exporters; (iii) include tariffs in the base price for imported goods.

2. **Income tax:** (i) maintain the maximum personal income tax rate and the corporate tax at 30 percent; (ii) reduce the minimum taxable personal income (currently at about 8 times the income per capita); (iii) eliminate most deductions to the personal income base; (iv) eliminate all exemptions to the corporate income tax; (v) extend the minimum tax on gross income/assets beyond 1999, while income tax administration is improved.

3. **Excises:** (i) increase the tax on all petroleum derivatives; (ii) change the beverages tax from ad-valorem to a unit tax per liter; (iii) increase the vehicle tax.

4. **Tax administration:** (i) strengthen human and capital resources of tax collection agencies (future SAT); (ii) strengthen fiscalization and establish systematic audit plans, with more emphasis on the VAT and on large taxpayers (including with the creation of the unit for "special taxpayers" within the SAT); (iii) increase penalties for noncompliance and simplify procedures (including modifications to the tax code to facilitate closing of establishments at first tax violation, and eliminate the limit of 20 percent for the penalties).

Box 2. Social and Institutional Expenditures

There are three common threads in the new peace expenditure programs: (1) **expansion in access to social services**, especially to the poor, indigenous rural population, (2) **decentralization**, with an emphasis on community and private sector participation in service delivery and (3) **economy**, through the use of such techniques as improved financial management, contracting out, competitive procurement practices and cost-benefit analysis to choose programs.

Education. Literacy and primary school enrollment rates are low, while dropout, desertion and repetition rates are high. The primary objectives are to expand the coverage and improve the quality of educational services, with emphasis on rural and poor areas. The main programs are (1) expansion of the PRONADE model of community and parent managed primary schools in rural areas, (2) increase in public investment in rural schools by the social funds (FIS and FONAPAZ) and (3) expansion of adult literacy, schools and teachers offering bilingual education, teacher training and girls' education. The year 2000 goals of the peace program are to raise the literacy rate from 61 to 70 percent, primary school enrollment rate to 80 percent, to increase PRONADE school enrollment by 250,000 and to cut desertion by 50 percent.

Health. Especially in rural areas, infant and maternal mortality rates are high; 64 percent of the deaths caused by diseases could be prevented through basic sanitation and basic health care (immunizations and pre-natal care). Primary objective is to expand coverage to rural, poor areas through: (1) SIAS, a community-based program to deliver basic health services by private contractors, (2) community based water and sanitation projects undertaken by FIS and FONAPAZ, (3) support of indigenous Mayan medicine and (4) programs to expand and rehabilitate existing health posts, centers, and hospitals. The year 2000 goals are to cut infant and maternal mortality by 50 percent and to provide basic health service coverage to an additional 3.9 million people of the 5 million without access to coverage in 1995.

Governance. Justice services (courts, police, public prosecutors and public defenders) are not widely available in 331 municipalities and quality and timeliness of those services are seriously deficient. Primary objectives are (1) expansion of justice services in rural communities through programs to (a) create and expand a national civilian police force; (b) disband police functions of the army; (c) create and expand system of community based public defenders; (d) increase the number of courts and personnel in rural communities; and (2) an upgrade in the quality of justice services through programs to (a) create a career civil service for judges, (b) relieve judges from administrative duties, (c) expand training programs for the police, public prosecutors and judges, and (d) provide assistance for indigenous language speakers. The year 2000 goals are a civilian national police force of 20,000, 18 Centers for the Administration of Justice in rural areas, and an increase of about 130 in the number of judges.

Rural Land Tenure. Rural land tenure is highly skewed and legal titles to much of the rural land is unclear. Primary objectives are to (1) remove land ownership uncertainty and (2) expand owner occupant farmers. Main programs are (a) a national land titling and registry modernization program, (b) introduction of a system of land taxation and (c) a market-assisted land purchase program to resettle landless families displaced by the civil war. The year 2000 goals are (a) completion of a cadastre in 10 (of 22 departments) and completion of most of the dispute settlement and title registration in Peten, (b) modernization of land registry, and (c) 10,000 displaced families resettled on their own land.

Housing. The majority of the 69 percent of families that live in owner occupied dwellings do not hold formal legal title to the land, typically, as a result of too expensive zoning standards. Main objectives are to expand private sector production of low and middle income housing and to regularize the legal titles to illegally occupied urban land. Main programs will (1) regularize the title to land in existing neighborhoods located on invaded public lands by transferring public land to private use and establishing expedited procedures for obtaining legal titles, (2) change existing housing codes enacted at national and local levels so as to permit private landowners to legally subdivide and title land with a minimum level of services and (3) finance housing improvements and units on land for low and moderate income housing. The year 2000 goals are 41,000 regularized titles for land formerly illegally occupied and 45,000 low and middle income housing units.

program for 1998 projects a slowdown in credit expansion to the private sector to about 15 percent in 1998, or about in line with economic activity.

29. Reserve requirements are being reduced in steps to 19.6 percent of bank's deposit liabilities, and open market placements also would be needed to absorb the excess liquidity that would be created. The authorities are considering reducing reserve requirements further to 15 percent in a subsequent plan, probably during 1999, while maintaining remuneration on about one third of requirements. This reduction would facilitate the narrowing of intermediation spreads (currently around 12 percentage points) and the strengthening of financial intermediation. The authorities reiterated their intention to strengthen the financial position of the central bank in the face of the increased cost of monetary policy by earmarking one half of the privatization proceeds to help write off its large accumulated operating losses.

30. In March 1998 the central bank began placing a small amount of open market paper, mostly with instruments denominated in local currency, but a small portion was made with paper denominated in U.S. dollars (in exchange for the equivalent amount of local currency) which the central bank treats as part of its foreign reserve liabilities. The authorities said that they would limit the use of instruments denominated in U.S. dollars to cases where significant savings could be obtained in interest cost. The staff advised the authorities against the use of dollar instruments as short-term gains may come at the cost of increased central bank vulnerability to sudden changes in market conditions and the exchange rate.

31. The authorities have been monitoring closely the situation of a domestic financial group (holding 4 percent of the total assets of the banking system) which in 1997 the Superintendency of Banks (SB) identified as insolvent. In January 1998 the SB placed this financial group under a special oversight program whereby financial operations are being tightly restricted and capital deficiencies are to be replenished. The authorities have indicated that they would be prepared to intervene and liquidate the financial group in case this proved to be necessary following the special oversight program. As explained below, the authorities would be working at strengthening prudential norms and the legal and administrative supervisory powers of the SB, in a plan to be supported by the IDB.

D. Balance of Payments Outlook for 1998 and External Sector Policies

32. The external current account deficit is projected to widen to 4 percent of GDP in 1998, and the overall balance to achieve a small surplus. **Export growth** would slow to about 10 percent (in U.S. dollars) because of a decline in coffee prices and sugar volume, but nontraditional exports (which now account for 55 percent of total exports) are expected to maintain their strong pace of recent years (annual average increase of 15 percent since the early 1990s). **Import growth** is projected to slow to 15 percent in 1998, following the sharp acceleration in 1997. Net official capital and transfers are projected to increase in 1998 with the expansion of peace related projects. The authorities plan to continue to place long-term government bonds in the international market to cover part of the prospective fiscal deficit and to improve the overall debt profile. Long-term private inflows would be expected to

increase with progress in the privatization program while short-term flows are projected to subside after the strong increase in 1996–97 following the end of the internal civil conflict.

33. Despite the real appreciation of the quetzal since the early 1990s, Guatemala does not appear to have developed problems of competitiveness as evidenced by the strong growth and diversification of nontraditional exports and the narrowing of the current account deficit. The real appreciation of the quetzal (which offset a real depreciation in the 1980s) came in the wake of trade and financial reform early in the decade, which fostered private investment and raised productivity in a number of export driven agricultural and manufacturing areas.

34. On **exchange rate policy**, the authorities noted that in late 1997 and January 1998 the central bank intervention to support the quetzal had been made with the objective of mopping up excess liquidity of the banks, given the relatively strong NIR position. The authorities said that in the period ahead they expected only limited intervention in the foreign exchange market as they wanted to preserve the current level of international reserves, and were reactivating open market operations to keep monetary growth in line with the inflation target. Specifically, they stated their intention to intervene only to smooth out exchange rate fluctuations, while allowing the rate to reflect market conditions.

E. Structural Reforms

35. Structural reforms focus on the areas of privatization, financial sector reform, and public sector modernization, which are being supported by programs with the IBRD and IDB. On **privatization**, in the power sector the authorities are giving priority to power distribution, and plan to sell the government's ownership of EEGSA in 1998, followed by the sale of INDE's distribution enterprise. On telecommunications, the sale of TELGUA is expected in the second half of 1998. In preparation for this, telephone rates were adjusted in 1997 to international standards, including the elimination of cross subsidies. In addition, the government has signed management contracts for the state railroad company and the Guatemala Postal Service, and plans to extend such contracts to the management of ports, airports, and major toll highways. On **public sector reform**, in 1997 two new laws (Purchases and Procurement Act and Executive Branch Act) were enacted and a new system of financial accounting was implemented to support the efforts to modernize the state and increase efficiency. The laws added flexibility to the hiring of services by private firms, and would make it possible to move toward greater transparency and decentralization of government decisions. These laws together with an efficient operation of the SAT to improve tax administration would help reduce corruption and further improve governance.

36. **Financial sector reform** over the next two years would need to focus on modifying a weak and outdated legal framework to strengthen substantially the supervisory powers of the Superintendency of Banks, and the process for effectively dealing with problem institutions. Guatemala does not currently meet several of the Basle Core Principles for effective bank supervision. A Financial Sector Loan by the IDB is expected to cover legislative changes to: (i) grant more freedom to the SB in the application of regulations and sanctions; (ii) strengthen norms on capital adequacy, related-party lending, credit concentration, and

foreign exchange exposure; (iii) allow consolidated supervision of financial groups; and (iv) improve the mechanisms to timely identify and resolve problems with financial institutions. The new legislation is expected to be considered by the Monetary Board in the second half of 1998. In the meantime, the SB has proposed to the Board several initiatives within the existing legislation to strengthen surveillance of informal financial institutions and supervision of financial groups. Also, MAE has recommended a thorough diagnosis of the financial position of banks as a preventive measure to identify signals of problem institutions. The authorities have initiated such a diagnosis but it is still at an early stage.

37. On **trade liberalization**, the authorities plan to continue the progress made within the framework of the Central American Common Market (CACM) agreement. Import tariff ceilings would be reduced from 19 percent to 15 percent by 1999 (one year ahead of the CACM commitment). This would lower the effective rate of protection by some 10 percentage points on consumer goods and 5 percentage points on intermediate goods. The tariff structure, however, continues to exempt certain products (mostly textile-related products) from the maximum rate of 19 percent, and certain agricultural products enjoy safeguard provisions which allow tariffs above the maximum for imports in excess of quotas (e.g., poultry and poultry parts). While Guatemala's average tariff rate at 10 percent is relatively low, its tariff dispersion remains relatively large.

IV. MEDIUM-TERM OUTLOOK

38. Guatemala has achieved important progress in improving macroeconomic policies, and the medium term prospects for achieving more rapid growth would depend on the maintenance of these policies in the context of a sustained improvement in social conditions. Alternative scenarios were prepared on the basis of whether additional revenues can be mobilized for social programs, or whether social progress would continue to advance slowly and unevenly as in the past.

39. The **improved policy scenario (A)** is based upon the authorities' expressed intention to maintain a steady increase in government revenue over the next several years that would sustain the social undertakings of the peace accords over the long run. In this scenario, the fiscal deficit would rise temporarily in 1999–2001, and decline to sustainable levels around 2003–04. Confidence resulting from the peace process would raise private investment, while fiscal consolidation and financial reform would underpin the increase in national savings. The growth objectives of the peace accords (6 percent a year, or over 3 percent in per capita terms) could be achieved on the basis of a continuing increase in agricultural export capacity; increased efficiency and productivity resulting from structural reforms; and higher public and private investment. Over the longer run, the gradual integration of the large rural indigenous population into the market economy together with the strengthening of human capital through poverty reduction and improvement in basic education and preventive health should raise the productivity of labor and expand the domestic market.

40. The alternative, or **passive policy scenario (B)**, is based upon no additional actions to strengthen revenue, with the tax ratio remaining at around 9 percent of GDP. Corresponding downward adjustments (with respect to the improved policy scenario) are assumed to be made to expenditures to limit the fiscal deficit to reduced external flows. Peace related expenditures are assumed to rise only slowly. Domestic investment would remain at around 14 percent of GDP, as weak prospects of improved social conditions would dampen private investment. Growth of exports and remittances would gradually slow down from the high pace of recent years. Economic growth would remain at around 4-4½ percent.

41. To illustrate the potential risks of weakening the fiscal position by attempting to raise spending in the presence of low tax revenue, a third **fiscal imbalance scenario (C)** was prepared. In this case, the fiscal deficit rises rapidly and public savings remain low, while fiscally-supported reforms would be postponed. Domestic investment and economic growth would rise temporarily but would not be sustainable and a nonviable external position eventually would force a change in course.

V. STAFF APPRAISAL

42. Guatemala's macroeconomic performance has improved over the past three years. The fiscal and balance of payments positions have strengthened considerably, inflation has declined to single digits, and annual growth has been maintained at about 4 percent. Since the signing of the peace accords in December 1996, significant progress has been made in reducing the influence of the military, the building of a new civilian police, and the peaceful reinsertion of former combatants into the political process.

43. The challenge facing the authorities during 1998-99 (the last two years of the current administration) is to make clear progress in the implementation of the social and institutional programs of the peace accords, while consolidating macroeconomic stability. The key element in such an undertaking would be the sustained mobilization of domestic resources, which together with an increase in external aid flows, would fund the new peace related expenditures within a sound fiscal framework.

44. The administration recently gained congressional approval of a package of measures which is expected to raise government tax revenue above 9 percent in 1998. With higher revenue the authorities plan to accelerate implementation of new social programs, while limiting the fiscal deficit to about the anticipated net external financing. However, because the tax package is not sufficiently comprehensive and includes temporary measures, the tax ratio is likely to fall back in 1999 and 2000. This situation, if not corrected, would pose the risk of either raising the fiscal imbalance to high levels or reversing progress in the implementation of social programs. It is essential, therefore, that the authorities strengthen tax policy as soon as possible to achieve a revenue increase on a permanent basis, to sustain the implementation of the new peace related programs without interruptions over the medium and long term. The role of the **peace commission** (which oversees implementation of the peace accords) could be

crucial in helping the government to gain the necessary political consensus for the required additional tax actions.

45. The staff has recommended, among possible measures, the extension of the gross income tax beyond 1999, the postponement of the scheduled reduction in income tax rates, the further adjustment of the fuel consumption tax with as broad a coverage as possible, and the elimination of most tax exemptions. In addition, the authorities would be well advised to reconsider the possible increase in the VAT rate which in Guatemala remains among the lowest in the Latin American region. The authorities are making efforts at improving tax compliance, and the approval of legislation for the creation of a Superintendency of Tax Administration (SAT) is a welcome development. However, as it likely would take time for administrative improvements to yield significant results, it would be important that the authorities accelerate the initiation of activities of the SAT (possibly earlier than currently scheduled for 1999), while further strengthening tax code legislation to facilitate the application of sanctions. On the expenditure side, the authorities should continue their efforts at shifting expenditure priorities from the military and other nonproductive areas toward the social sectors, while continuing to improve the quality and targeting of social outlays. Tight control over the wage bill in the period ahead would be essential.

46. With the prospect of a moderate increase in the fiscal deficit in 1998, the authorities have appropriately programmed a tightening in credit policy to safeguard the central bank international reserve position and to ensure that inflation remains in the single digits. To this end, it is important that the central bank carry out with determination its planned reactivation of open market operations as the main instrument of monetary control, while allowing domestic interest rates to increase, as needed, to neutralize excess demand pressures. The intensification of open market placements would facilitate the scheduled reduction of the relatively high reserve requirements on bank deposits with a view to improving financial intermediation. The staff would advise the authorities, however, against the use of dollar denominated open market paper, as the central bank could be unduly raising its vulnerability to a large currency depreciation resulting from sudden changes in market conditions.

47. Guatemala does not appear to have a problem of competitiveness at the present time, as evidenced by the strong growth and diversification of nontraditional exports and the improvement in the external current account in recent years. However, continued vigilance of developments in competitiveness should be maintained, particularly given the anticipated increase of fiscal pressure that could result with higher public expenditure. In this regard, it would be important that the central bank follows with determination its intended policy of allowing the exchange rate to reflect market conditions in the context of an appropriately tight credit policy, and thus refrain from the large interventions in the foreign exchange market that were made in the recent past. Maintaining a strong competitive position over the medium term hinges importantly on a sound fiscal position and continued progress in structural reform to help sustain an increase in private investment and labor productivity.

48. In the structural area, the authorities have made important progress in the legislative framework to advance public sector modernization and privatization. The actions taken to

bring power rates in line with costs and telephone rates with international standards are welcome, as these would facilitate the divestment process. Looking ahead, the authorities should press forward with their planned sale of the telephone company and the power distribution enterprises. The authorities plan to continue their trade policy of import tariff reduction in the context of the agreement of the Central American Common Market. Guatemala, however, like other CACM countries, still maintains a number of exemptions from the maximum tariff rates which results in a relatively large tariff dispersion. The staff would recommend that the authorities phase out most exemptions and move toward a more uniform tariff structure.

49. Guatemala's prudential regulations and supervisory oversight of the financial system present a number of weaknesses, as a consequence of serious deficiencies in an outdated banking legislation. The staff urges the authorities to move expeditiously in their program with the IDB to address the required legislative changes. Such changes are expected to cover the strengthening of powers of the Superintendency of Banks in the application of prudential regulations and sanctions, and to improve the mechanisms to identify and address promptly problems with financial institutions. In this connection, the authorities are strongly advised to act resolutely in resolving the problem of an insolvent financial group. The authorities also should promptly complete a thorough diagnosis of the financial position of a large number of institutions to identify warning signals of problem institutions.

50. The authorities are taking encouraging actions to improve governance. The already noted strengthening of the civilian police and reduction in the role of the military in the political process, together with the planned improvement of the justice system, are major steps in this direction. In addition, in the reform of the public sector, the authorities have strengthened the regulatory framework for public sector procurement which would permit increased transparency in government decisions. Diligent efforts at implementation in this area as well as decisive actions to improve tax administration would be effective steps to reduce corruption and further improve public accountability and governance practices.

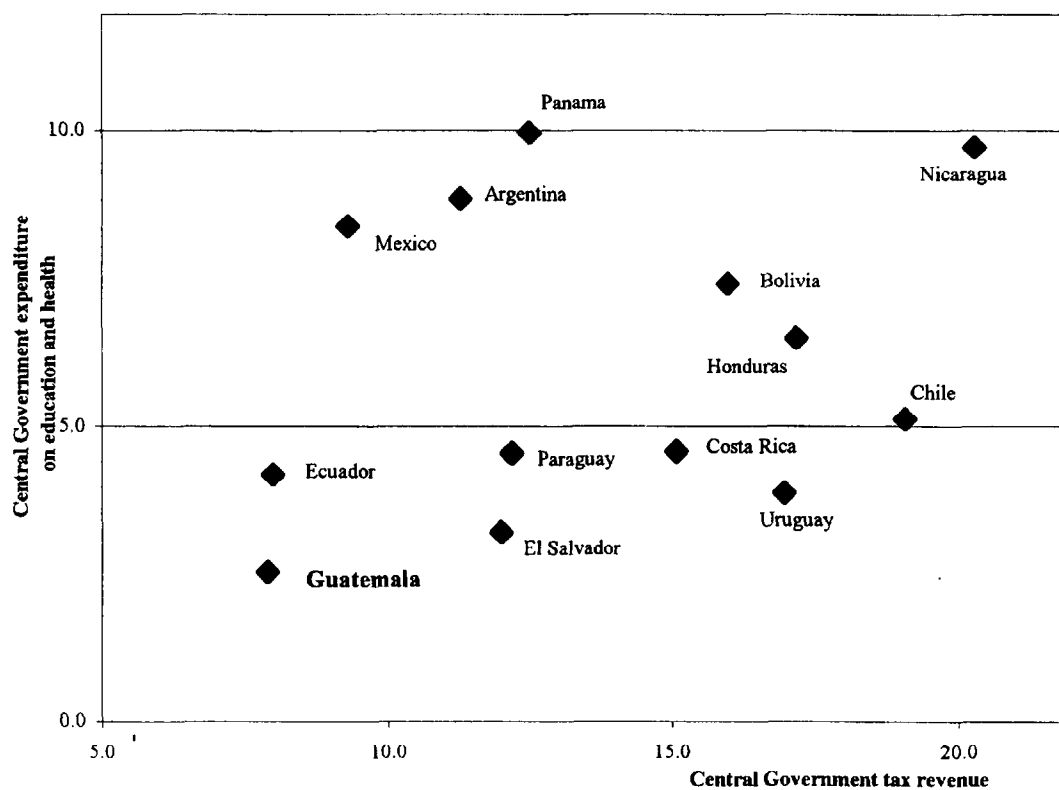
51. Guatemala's statistical information permits reasonable monitoring of financial developments, but problems remain in certain areas. In particular the authorities would need to correct recent increased delays and deficiencies in the provision of information on public revenue and expenditure. The authorities are addressing problems in national accounts, and monetary and balance of payments statistics, including with the Fund's technical assistance.

52. It is proposed that the next Article IV consultation with Guatemala be held on the standard 12-month cycle.

Table 3. Guatemala: Basic Indicators

Income	(in U.S. dollars)
GDP per capita (1997)	1,582
PPP adjusted	3,631
Income distribution	
Per capita income of	
Highest 20 percent	11,598
Lowest 20 percent	387
Social	(in percent)
Population growth	2.8
Poverty (percent of population)	75
Extreme poverty (percent of population)	58
Rural population	61
Indigenous population	40
Access to safe water	64
Sources: IMF staff estimates; and World Bank.	

Figure 1
Latin American Countries: Central Government Expenditure on Health
and Education and Tax Revenue, 1995
(in percent of GDP)



Source: Table 6

Table 4. Guatemala: Selected Economic Indicators

	1993	1994	1995	1996	Prel. 1997	Proj. 1998
Exchange rate, average (Quetzal/ U.S. dollar)	5.6	5.8	5.8	6.1	6.1	...
(Annual percentage changes, unless otherwise specified)						
National income and prices						
GDP at constant prices	3.9	4.0	4.9	3.0	4.1	4.5
GDP deflator	14.5	11.7	8.7	8.9	8.6	7.9
Consumer prices (annual averages)	13.4	12.5	8.4	11.0	9.3	6.5
(end of period)	11.6	11.6	8.6	10.8	7.1	7.0
External sector (in U.S. dollars)						
Exports, f.o.b.	5.9	15.4	27.8	3.8	16.3	10.1
Imports, c.i.f.	2.7	7.0	18.4	-4.4	20.8	12.5
Export volume	9.6	5.0	6.5	14.3	14.4	4.8
Import volume	4.0	4.8	13.5	-4.2	24.8	16.1
Terms of trade (deterioration -)	-2.0	7.7	15.0	-9.0	5.1	8.5
Nominal effective exchange rate						
end of period (depreciation -)	8.7	11.3	-1.7	2.6	3.0	...
Real effective exchange rate,						
end of period (depreciation -)	1.5	7.6	0.0	7.5	6.8	...
Central government						
Central government revenue	4.8	-1.1	26.7	19.6	12.0	22.6
Central government expenditure	19.5	0.2	16.6	10.4	22.6	27.8
Money and credit						
Liabilities to private sector (banking system)	18.5	17.3	14.7	13.7	15.5	15.0
Net domestic assets of the banking system 1/	12.2	21.7	17.2	10.8	9.1	12.3
Of which:						
Credit to nonfinancial public sector	-0.5	-3.9	-3.6	-4.4	-6.7	-0.4
Credit to private sector	7.8	17.1	19.9	7.5	13.5	10.6
(In percent of GDP)						
Combined public sector deficit						
(including central bank losses)	-2.5	-2.3	-0.9	-0.1	-0.5	-1.1
Overall balance of the nonfinancial public sector (deficit -)	-1.4	-1.1	0.1	1.1	0.3	-0.8
Foreign financing 2/	1.6	1.7	-0.2	0.2	2.0	1.4
Domestic financing	-0.3	-0.6	0.2	-1.2	-2.4	-0.6
Nonfinancial public sector savings	2.1	2.0	3.0	4.3	4.4	3.7
Central government overall balance (deficit -)	-2.0	-1.6	-0.6	-0.2	-0.7	-1.6
Current account of the balance of payments (deficit -)	-6.6	-5.5	-4.1	-2.8	-3.5	-4.0
External public debt (end of period)	19.5	18.6	16.1	15.2	14.8	15.2
(As percent of exports of goods and nonfactor services)						
Debt service 3/	14.4	15.6	14.3	10.7	9.4	8.8
Of which:						
Interest	5.6	5.8	4.7	4.9	2.9	3.1
(In millions of U.S. dollars)						
Overall external balance (deficit -)	209.0	-4.5	-185.4	187.9	288.9	111.0
Of which:						
Net official reserves (increase-)	-205.6	-59.8	157.3	-176.4	-287.0	-100.0
External arrears	58.6	87.7	115.8	103.9	0.0	0.0
Gross official reserves						
(in months of goods and nonfactor services)	3.5	3.2	2.3	3.0	3.1	3.1

Source: Bank of Guatemala, Ministry of Finance, and Fund staff estimates.

1/ In relation to the stock of liabilities to the private sector at the beginning of the period.

2/ Includes foreign grants and changes in arrears.

3/ Public sector medium- and long-term debt.

Table 5. Guatemala: Indicators of External and Financial Vulnerability

	1991- 1994	1995	1996	Prel. 1997
Financial indicators				
Public sector debt (in percent of GDP)	18.9	22.0	21.2	18.1
Broad money (12-month percentage change)	25.0	14.7	13.7	15.5
Private sector credit (12-month percentage change)	28.0	33.2	10.7	19.9
Financial margin (banking spread)	11.2	10.0	11.6	10.5
180 day central bank paper yield	16.1	22.2	18.0	9.2
182 day central bank paper yield (real)	-2.3	12.6	6.4	2.0
Financial sector risk indicators				
Share of non-performing loans in total loans 1/	3.9	9.2	9.5	...
Capital adequacy ratio 2/	12.6	14.2	12.7	...
Foreign currency debt rating 3/	...	...	...	Ba2
External Indicators				
Exchange rate per US\$ (period average)	5.4	5.8	6.1	6.1
In millions of US dollars				
Current account balance	-617	-600	-443	-630
Capital account balance	699	380	583	889
Gross official reserves	832	707	884	1124
Central bank short-term foreign liabilities	177	68	69	22
Short term foreign assets of the financial sector 4/	7	59	78	74
Short term foreign liabilities of the financial sector 4/	103	286	417	465
Public sector external debt	2320	2348	2380	2620
Ratios				
Gross reserves in months of imports of goods and nonfactor services	3.7	2.3	3.0	3.2
Net International Reserves to M2	27.1	19.8	22.3	24.4
Net International Reserves to total short-term external debt	233.0	313.6	454.4	445.6
Total external debt to exports of goods and nonfactor services	119.4	83.9	85.3	78.4
External interest payments to exports of goods and nonfactor services	6.3	4.3	4.7	2.7
External amortization payments to exports of goods and nonfactor services	9.0	6.9	5.3	5.2
12-month percentage change				
Exports	7.9	27.8	3.8	16.3
Imports	14.7	18.4	-4.4	20.8
Terms of Trade	-1.0	15.0	-9.0	5.1
Real Effective Exchange Rate depreciation (-)	5.3	0.0	7.5	7.6

Source: Bank of Guatemala and Fund staff estimates.

1/ Non-performing loans were redefined in 1995 in accordance with the Basle guidelines.

2/ Following the Basel principles, the Monetary Board approved new capital requirements in 1994. Risk-based capital requirements are calculated on a per-bank basis and, therefore, these ratios do not consolidate financial groups risk. In addition, deficiencies in the loan classification system might lessen the significance of these indicators.

3/ Moodys rated Guatemala for the first time in July 1997, and the first rating was for long-term foreign currency bonds placed in the Euromarket.

4/ Commercial banks and financial institutions.

Table 6. Guatemala: Comparative Indicators With Latin America

A. Central Government Tax Revenue and Government Spending in Health and Education
(in percent of GDP)

	Tax Revenue	Health and Education Expenditures	Level of Government for Expenditures
Argentina	11.3	8.8	General
Bolivia	16.0	7.4	Central
Chile	19.1	5.1	Central
Costa Rica	15.1	4.6	Central
Ecuador	8.0	4.2	Central
El Salvador	12.0	3.2	Central
Guatemala	7.9	2.5	Central
Honduras	17.2	6.5	Central
Mexico	9.3	8.4	Central
Nicaragua	20.3	9.7	Central
Panama	12.5	10.0	Central
Paraguay	12.2	4.6	Central
Uruguay	17.0	3.9	Central

Source: Recent Economic Developments for central government tax revenue (excludes nontax oil revenue). Social spending database of Fiscal Affairs Department for health and education expenditures.

B. Comparative Social Indicators

	Guatemala			Latin America		
	1975	1985	1995	1975	1985	1995
GNP per capita (U.S. dollars)	620	1,150	1,340	1,192	1,836	3,320
Infant mortality 1/	103	70	44	82	56	37
Primary school gross enrollment rate 2/	61	76	84	99	107	110
Secondary school enrollment rate 2/	12	19	24	35	48	51
Percent illiterate (age 15 +) 3/	54	48	44	26	17	14
Child malnutrition 4/	...	44	29	...	...	11
Life expectancy (years)	54	59	65	61	65	69
Gini index 5/	...	...	59	...	...	49

Sources: "Social Indicators of Development, 1997," World Bank; "Health in Central America and Panama, 1998," World Bank; "Guatemala at a Glance, 1998," World Bank; Deininger K. and L. Squire, "Measuring Income Inequality: A New Data-Base," Development Discussion Paper No. 537, Conference Paper Series.

1/ Per thousand of live births.

2/ In percent of school age population. Last year for which data are available is 1993.

3/ Last year for which data are available for Latin America as a whole is 1994.

4/ In percent of age group under five. Last year for which data are available is 1990.

5/ 1989 for Guatemala and average 1980-90 for Latin America.

Table 7. Guatemala: Operations of the Combined Public Sector

	1993	1994	1995	1996	Prel. 1997	Proj. 1998
(In millions of quetzales)						
Combined public sector balance	-1,592	-1,742	-739	-129	-501	-1,393
Current account	610	588	1,759	2,931	3,916	4,111
Nonfinancial public sector	-870	-825	55	1,009	331	-989
Current account	1,332	1,504	2,553	4,070	4,747	4,515
Central government	-1,288	-1,230	-520	-177	-717	-1,936
Current account	312	467	1,525	2,418	3,128	2,887
Rest of the nonfinancial public sector	418	405	575	1,187	1,048	947
Current account	1,020	1,038	1,028	1,651	1,619	1,628
Bank of Guatemala losses	-722	-916	-794	-1,139	-832	-404
Nonfinancial public sector financing	870	825	-55	-1,009	-331	989
External (net)	1,055	1,238	-196	151	2,208	1,682
Of which:						
Foreign loans (net)	155	660	52	247	541	759
Bonded debt	876	316	-454	-79	1,477	777
Domestic (net)	-185	-413	141	-1,160	-2,539	-693
(In percent of GDP)						
Combined public sector balance	-2.5	-2.3	-0.9	-0.1	-0.5	-1.1
Current account	0.9	0.8	2.1	3.1	3.6	3.4
Nonfinancial public sector	-1.4	-1.1	0.1	1.1	0.3	-0.8
Current account	2.1	2.0	3.0	4.3	4.4	3.7
Central government	-2.0	-1.6	-0.6	-0.2	-0.7	-1.6
Current account	0.5	0.6	1.8	2.5	2.9	2.4
Rest of the nonfinancial public sector	0.7	0.5	0.7	1.2	1.0	0.8
Current account	1.6	1.4	1.2	1.7	1.5	1.3
Bank of Guatemala losses	-1.1	-1.2	-0.9	-1.2	-0.8	-0.3
Nonfinancial public sector financing	1.4	1.1	-0.1	-1.1	-0.3	0.8
External (net)	1.6	1.7	-0.2	0.2	2.0	1.4
Of which:						
Foreign loans (net)	0.2	0.9	0.1	0.3	0.5	0.6
Bonded debt	1.4	0.4	-0.5	-0.1	1.4	0.6
Domestic (net)	-0.3	-0.6	0.2	-1.2	-2.4	-0.6

Sources: Ministry of Finance, IGSS, INDE, GUATEL, Bank of Guatemala, and Fund staff estimates.

Table 8. Guatemala: Summary of Central Government Operations

	1993	1994	1995	1996	Prel. 1997	Proj. 1998
(In millions of quetzales)						
Total revenue	5,745	5,684	7,345	8,786	9,838	12,057
Tax revenue 1/	5,027	5,055	6,735	8,332	9,454	11,167
Direct taxes	1,226	902	1,407	2,024	2,320	2,558
Indirect taxes	3,801	4,153	5,328	6,308	7,133	8,609
Of which:						
Value-added tax	1,679	1,883	2,401	3,488	3,952	4,876
Nontax revenue	255	301	307	222	230	581
Transfers	463	328	303	232	154	309
Total expenditures	6,877	6,887	8,097	8,937	10,917	13,993
Current expenditures	5,433	5,217	5,820	6,368	6,710	9,170
Wages and salaries	2,117	2,202	2,580	2,657	2,878	3,643
Goods and services	895	791	712	781	1,017	1,511
Interest	720	818	1,065	1,141	838	1,072
Transfers	1,701	1,407	1,463	1,789	1,977	2,944
Capital expenditure	1,444	1,670	2,277	2,569	4,207	4,823
Of which:						
Fixed capital formation	629	655	1,081	1,236	1,787	2,072
Current account balance	312	467	1,525	2,418	3,128	2,887
Overall balance (deficit -)	-1,132	-1,204	-752	-151	-1,079	-1,936
Statistical discrepancy	-156	-26	232	-27	362	0
Overall balance, adjusted (deficit -)	-1,288	-1,230	-520	-177	-717	-1,936
Financing	1,288	1,230	520	177	717	1,936
External	1,119	1,369	74	484	2,384	1,764
Domestic (net)	169	-139	445	-307	-1,667	172
(In percent of GDP)						
Total revenue	8.9	7.6	8.6	9.2	9.1	9.9
Tax revenue	7.8	6.8	7.9	8.7	8.8	9.2
Nontax revenue	0.4	0.4	0.4	0.2	0.2	0.5
Transfers	0.7	0.4	0.4	0.2	0.1	0.3
Total expenditure	10.7	9.2	9.5	9.4	10.1	11.5
Current expenditure	8.5	7.0	6.8	6.7	6.2	7.5
Of which:						
Wages and salaries	3.3	2.9	3.0	2.8	2.7	3.0
Capital expenditure	2.2	2.2	2.7	2.7	3.9	4.0
Of which:						
Fixed capital formation	1.0	0.9	1.3	1.3	1.7	1.7
Current account balance	0.5	0.6	1.8	2.5	2.9	2.4
Overall balance (deficit -)	-1.8	-1.6	-0.9	-0.2	-1.0	-1.6
Statistical discrepancy	-0.2	0.0	0.3	0.0	0.3	0.0
Overall balance, adjusted (deficit -)	-2.0	-1.6	-0.6	-0.2	-0.7	-1.6
Financing	2.0	1.6	0.6	0.2	0.7	1.6
External (net)	1.7	1.8	0.1	0.5	2.2	1.5
Domestic (net)	0.3	-0.2	0.5	-0.3	-1.5	0.1

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

1/ Starting 1995, includes earmarked revenues (the counterpart is included in current and capital transfers), tax penalties and *regalias petroleras*.

Table 9. Guatemala: Central Government Expenditure by Function

	1993	1994	1995	1996	Est. 1997
(In millions of quetzales)					
Total	6,877	6,887	8,097	8,937	10,917
Internal security	164	242	289	...	...
Defense	685	806	843	1,074	...
Social sectors	3,088	3,294	3,579	3,865	5,247
Current	2,118	2,319	2,441	2,541	3,138
Capital	970	976	1,138	1,328	2,109
Education	1,158	1,272	1,352	1,433	1,671
Health	624	625	719	724	882
Social security and welfare	516	592	600	633	837
Housing and community services	598	454	505	669	1,085
Social funds	193	352	403	407	772
Education	0	74	60	68	165
Health	0	77	32	82	138
Other expenditures through social funds	193	201	311	257	469
Economic services	1,151	917	1,105	1,114	...
Other	2,940	2,545	3,386	3,997	5,670
(In percent of GDP)					
Total	10.7	9.2	9.5	9.4	10.1
Internal security	0.3	0.3	0.3	...	...
Defense	1.1	1.1	1.0	1.1	...
Social sectors	4.8	4.4	4.2	4.0	4.9
Current	3.3	3.1	2.9	2.7	2.9
Capital	1.5	1.3	1.3	1.4	2.0
Education	1.8	1.7	1.6	1.5	1.5
Health	1.0	0.8	0.8	0.8	0.8
Social security and welfare	0.8	0.8	0.7	0.7	0.8
Housing and community services	0.9	0.6	0.6	0.7	1.0
Social funds	0.3	0.5	0.5	0.4	0.7
Education	0.0	0.1	0.1	0.1	0.2
Health	0.0	0.1	0.0	0.1	0.1
Other expenditures through social funds	0.3	0.3	0.4	0.3	0.4
Economic services	1.8	1.2	1.3	1.2	0.0
Other	2.8	2.2	2.7	3.0	5.3
(In percent of total)					
Total	100.0	100.0	100.0	100.0	100.0
Internal security	2.4	3.5	3.6	...	...
Defense	10.0	11.7	10.4	12.0	...
Social sectors	44.9	47.8	44.2	43.3	48.1
Current	30.8	33.7	30.1	28.4	28.7
Capital	14.1	14.2	14.1	14.9	19.3
Education	16.8	18.5	16.7	16.0	15.3
Health	9.1	9.1	8.9	8.1	8.1
Social security and welfare	7.5	8.6	7.4	7.1	7.7
Housing and community services	8.7	6.6	6.2	7.5	9.9
Social funds	2.8	5.1	5.0	4.5	7.1
Education	0.0	1.1	0.7	0.8	1.5
Health	0.0	1.1	0.4	0.9	1.3
Other expenditures through social funds	2.8	2.9	3.8	2.9	4.3
Economic services	16.7	13.3	13.6	12.5	0.0
Other	26.0	23.6	28.2	32.3	51.9

Sources: Ministry of Finance; and Fund staff estimates.

Table 10. Guatemala: Summary Accounts of the Monetary Authorities

	1993	1994	1994 1/	1995	1996	1997	Proj. 1998
Exchange rate (Quetzales/U.S. dollars)	5.8	5.8	6.0	6.0	6.0	6.0	6.0
(Stocks in millions of quetzales)							
Net official reserves	4272	4619	4778	3835	4894	6615	7215
In millions of U.S. dollars	737	796	796	639	816	1103	1203
Net domestic assets	-859	-541	-700	624	-74	-1139	-1134
Net claims on nonfinancial							
public sector	-139	-970	-970	-1605	-3100	-5836	-6249
Central government	1266	438	438	285	-629	-2692	-2630
Rest of nonfinancial public sector	-1405	-1408	-1408	-1889	-2472	-3144	-3619
Bank of Guatemala losses	4134	5050	5050	5844	6983	7815	8219
Net credit to banks	-3510	-3982	-3982	-3831	-4294	-5538	-4851
<i>Of which</i>							
Reserves 2/	-3720	-4134	-4134	-3954	-4392	-5620	-4931
Open market operations	-3014	-2687	-2708	-2032	-2392	-242	-920
Medium -and long- term							
foreign liabilities	-1992	-1661	-1718	-1412	-1232	-976	-772
Other assets (net)	3662	3709	3627	3660	3963	3638	3439
Currency issue	3413	4078	4078	4459	4820	5476	6081
(Flows in millions of quetzales)							
Net official reserves		346.84		-943.20	1058.40	1721.40	600.00
In millions of U.S. dollars		59.80		-157.20	176.40	286.90	100.00
Net domestic assets		318.46		1323.90	-697.60	-1065.10	4.60
Net claims on nonfinancial							
public sector		-831.10		-634.90	-1495.70	-2735.50	-413.60
Bank of Guatemala losses		916.40		794.30	1138.60	831.70	404.00
Net credit to banks		-472.20		150.60	-463.10	-1243.60	686.40
<i>Of which</i>							
Reserves 2/		-414.50		179.90	-437.40	-1227.90	688.30
Open market operations		326.86		676.20	-360.30	2149.90	-677.30
Medium -and long- term							
foreign liabilities		331.76		305.40	180.00	256.80	204.00
Other assets (net)		46.74		32.30	302.90	-324.40	-198.90
Currency issue		665.30		380.70	360.80	656.30	604.60
(12-month percentage change over the stock of currency issued at the beginning of the period)							
Net domestic assets		9.3		32.5	-17.1	-22.1	0.1
Net claims on nonfinancial							
public sector		-24.4		-15.6	-36.7	-56.8	-7.6
Bank of Guatemala losses		26.9		19.5	27.9	17.3	7.4
Currency issue		19.5		9.3	8.8	13.6	11.0

Sources: Bank of Guatemala and Fund staff estimates.

1/ Two columns for 1994 are shown to ensure comparability of some central bank assets and liabilities valued at different exchange rates (Q 5.8 and Q 6 per dollar).

2/ Includes cash, deposits and obligatory investments.

Table 11. Guatemala: Summary Accounts of the Banking System

	1993	1994	1994 1/	1995	1996	Prel. 1997	Proj. 1998
Exchange rate (Quetzales/U.S. dollars)	5.8	5.8	6.0	6.0	6.0	6.0	6.0
(Stocks in millions of quetzales)							
Net foreign assets	3738	2709	3431	2589	3041	4441	5041
Net domestic assets	15116	18743	17982	21325	23742	26048	29649
Net claims on nonfinancial							
public sector	-91	-746	-794	-1493	-2475	-4182	-4290
Central government	1559	937	889	528	10	-1193	-1193
Rest of nonfinancial public sector	-1650	-1683	-1683	-2021	-2485	-2989	-3097
Bank of Guatemala losses	4134	5050	5050	5844	6983	7815	8219
Credit to private sector and							
other investments 2/	8649	11516	11715	15601	17268	20700	23805
Other assets (net)	2424	2923	2011	1373	1966	1715	1916
Medium- and long-term foreign liabilities	2104	1811	1924	1558	1361	1120	916
Liabilities to the private sector	16750	19640	19490	22356	25422	29369	33775
Money	4947	6945	6910	7670	8764	11293	12874
Quasi-money	11803	12695	12580	14686	16658	18076	20901
(Flows in millions of quetzales)							
Net foreign assets	-1029.32			-842.89	452.38	1400.20	600.01
Net domestic assets	3627.13			3343.32	2416.90	2305.70	3601.33
Net claims on nonfinancial							
public sector	-654.60			-699.20	-981.60	-1707.20	-108.10
Bank of Guatemala losses	916.40			794.30	1138.60	831.70	404.00
Credit to private sector 2/	2866.70			3885.70	1667.30	3431.70	3105.00
Other assets (net)	498.63			-637.48	592.60	-250.50	200.43
Medium- and long-term foreign liabilities	-292.40			-365.67	-197.13	-241.20	-204.06
Liabilities to the private sector	2890.20			2866.10	3066.40	3947.10	4405.40
Money	1998.60			760.80	1093.80	2528.80	1581.00
Quasi-money	891.60			2105.30	1972.60	1418.30	2824.40
(12-month percentage change over initial stock of liabilities to the private sector)							
Net domestic assets	21.7			17.2	10.8	9.1	12.3
Net claims on nonfinancial							
public sector	-3.9			-3.6	-4.4	-6.7	-0.4
Credit to private sector 2/	17.1			19.9	7.5	13.5	10.6
Liabilities to the private sector	17.3			14.7	13.7	15.5	15.0
Money	11.9			3.9	4.9	9.9	5.4
Quasi-money	5.3			10.8	8.8	5.6	9.6
(12-month percentage change)							
Memorandum item:							
Credit to private sector and							
other investments 2/	33.1			33.2	10.7	19.9	15.0

Sources: Bank of Guatemala and Fund staff estimates.

1/ Two columns for 1994 are shown to ensure comparability of some commercial banks assets and liabilities valued at different exchange rates (Q 5.8 and Q 6 per dollar).

2/ Includes credit to the private sector and nonbank financial intermediaries, and accounts receivable in foreign currency.

Table 12. Guatemala: Summary Balance of Payments

	1993	1994	1995	1996	Est. 1997	Proj 1998
(In millions of U.S. dollars)						
Current account	-750	-707	-600	-443	-630	-777
Trade balance	-1,138	-1,095	-1,137	-909	-1,200	-1,411
Exports, f.o.b.	1,462	1,687	2,156	2,237	2,602	2,866
Imports, c.i.f.	-2,599	-2,781	-3,292	-3,146	-3,802	-4,277
Services	77	2	43	-56	36	64
Factor services (net)	-107	-142	-172	-205	-178	-190
Of which:						
Interest on public debt	-113	-132	-132	-138	-98	-116
Nonfactor (net)	184	144	216	149	214	254
Private transfers (net)	311	386	494	522	534	570
Capital account	959	543	380	583	889	863
Official transfers	52	62	59	65	78	90
Public sector	14	54	-144	-71	240	196
Disbursements	102	105	84	92	142	184
Privatization				0	0	0
Amortization	-178	-173	-143	-149	-146	-122
Bonds (net)	90	121	-85	-13	243	135
Private sector 1/	893	427	465	589	571	577
Balance of payments support	0	159	35	48	30	25
Overall balance	209	-5	-185	188	289	111
Change in net official reserves	-206	-60	157	-176	-287	-100
Total arrears (-decrease)	-473	29	28	-11	-2	-103
Rescheduling of arrears	455	35	0	0	0	92
Resch. current obligations	14	0	0	0	0	0
(Annual percentage change)						
Exports, f.o.b.	5.9	15.4	27.8	3.8	16.3	10.1
Imports, c.i.f.	2.7	7.0	18.4	-4.4	20.8	12.5
(In percent of GDP)						
Current account	-6.6	-5.5	-4.1	-2.8	-3.5	-4.0
Trade account	-10.1	-8.5	-7.8	-5.8	-6.7	-7.2
Exports	12.9	13.0	14.8	14.3	14.6	14.7
Imports	-23.0	-21.5	-22.5	-20.1	-21.4	-22.0
Services	0.7	0.0	0.3	-0.4	0.2	0.3
Private transfers	2.8	3.0	3.4	3.3	3.0	2.9
Capital account (excluding Bop support)	8.5	5.4	2.8	4.0	5.2	4.6
Private capital inflows	7.9	3.3	3.2	3.8	3.2	3.0
Memorandum items:						
Gross official reserves 2/	3.5	3.2	2.3	3.0	3.1	3.1
Debt service ratio 3/	14.4	15.6	14.3	10.7	9.9	8.8
Interest	5.6	5.8	4.7	4.9	2.9	3.1
Amortization	8.8	9.8	9.6	5.8	7.0	5.6

Sources: Central Bank of Guatemala, Ministry of Finance, and Fund staff estimates.

1/ Includes errors and omissions.

2/ In months of imports of goods and nonfactor services.

3/ Debt service of public sector over exports of goods and nonfactor services.

Table 13. Guatemala: Medium-Term Projections
A. Improved Policy Scenario: Increasing Tax Ratio

	1995	1996	Prel.	Projection							
			1997	1998	1999	2000	2001	2002	2003	2004	2005
Real GDP growth	4.9	3.0	4.1	4.5	4.8	5.0	5.3	5.7	6.0	6.2	6.6
ICOR	3.1	4.2	3.4	3.2	3.2	3.2	3.1	3.0	2.9	2.9	2.9
(In percent of GDP)											
Savings and Investment											
Gross domestic investment	15.1	12.6	14.1	14.4	15.4	16.1	16.6	17.1	17.5	18.1	19.0
Public	3.0	3.1	4.1	4.5	5.4	5.8	6.2	6.4	6.5	6.5	6.2
Private	12.1	9.5	10.0	9.9	10.0	10.3	10.4	10.7	11.0	11.6	12.8
National savings	11.0	9.8	10.6	10.4	10.9	11.6	12.3	13.0	13.6	14.4	15.4
Public	2.1	3.0	3.6	3.4	3.8	4.4	5.0	5.5	6.0	6.4	6.4
Private	8.9	6.8	7.0	7.0	7.1	7.2	7.3	7.4	7.6	8.0	9.0
Public sector											
Overall balance combined public sector	-0.9	-0.1	-0.5	-1.1	-1.6	-1.5	-1.2	-0.9	-0.5	-0.1	0.2
Financing	0.9	0.1	0.5	1.1	1.6	1.5	1.2	0.9	0.5	0.1	-0.2
External (net)	-0.2	0.1	2.0	1.4	1.6	1.5	1.2	0.9	0.5	0.1	-0.2
Domestic (net)	1.1	0.0	-1.5	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Central government											
Revenues	8.6	9.1	9.1	9.9	10.7	11.4	12.2	12.9	13.4	13.6	13.9
Of which:											
Tax revenues	7.9	8.7	8.8	9.2	10.0	10.7	11.5	12.0	12.5	12.7	13.0
Expenditures	9.5	9.3	10.1	11.5	12.7	13.4	14.0	14.3	14.7	14.5	14.5
Of which:											
Social and other new peace related	4.2	4.0	4.9	6.6	7.9	8.8	9.7	10.3	10.7	10.7	10.7
External sector											
Current account	-4.1	-2.8	-3.5	-4.0	-4.5	-4.5	-4.3	-4.1	-3.9	-3.7	-3.5
Of which:											
Exports, f.o.b.	14.8	14.3	14.6	14.7	14.8	15.3	15.7	16.0	16.3	16.5	16.7
Imports, c.i.f.	-22.5	-20.1	-21.4	-22.0	-22.5	-23.1	-23.3	-23.4	-23.6	-23.5	-23.5
Capital account	2.8	4.0	5.2	4.6	5.0	5.0	4.8	4.4	4.3	4.1	3.9
Official capital	-0.3	0.3	1.5	1.6	1.9	1.8	1.5	1.1	0.8	0.3	0.1
Of which:											
Nonfinancial public sector	-0.2	0.1	2.0	1.4	1.6	1.5	1.2	0.9	0.5	0.1	-0.2
Private sector	3.2	3.8	3.2	3.0	3.1	3.2	3.3	3.3	3.5	3.8	3.8

Source: Fund staff estimates.

Table 13. Guatemala: Medium-Term Projections
B. Passive Policy Scenario: Low Tax Ratio

	1995	1996	Prel.	Projection							
			1997	1998	1999	2000	2001	2002	2003	2004	2005
Real GDP growth	4.9	3.0	4.1	4.5	4.5	4.4	4.4	4.5	4.5	4.5	4.5
ICOR	3.1	4.2	3.4	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.3
(In percent of GDP)											
Savings and Investment											
Gross domestic investment	15.1	12.6	14.1	14.4	14.2	14.1	14.2	14.4	14.4	14.5	14.8
Public	3.0	3.1	4.1	4.5	4.2	4.1	4.0	4.0	3.9	3.8	3.8
Private	12.1	9.5	10.0	9.9	10.0	10.0	10.2	10.4	10.5	10.7	11.0
National savings	11.0	9.8	10.6	10.4	10.6	10.7	10.9	11.2	11.3	11.8	12.2
Public	2.1	3.0	3.6	3.4	3.2	3.3	3.4	3.6	3.6	3.9	4.0
Private	8.9	6.8	7.0	7.0	7.4	7.4	7.5	7.6	7.7	7.9	8.2
Public sector											
Overall balance combined public sector	-0.9	-0.1	-0.5	-1.1	-1.0	-0.8	-0.6	-0.4	-0.3	0.1	0.2
Financing	0.9	0.1	0.5	1.1	1.0	0.8	0.6	0.4	0.3	-0.1	-0.2
External (net)	-0.2	0.1	2.0	1.4	1.0	0.8	0.6	0.4	0.3	-0.1	-0.2
Domestic (net)	1.1	0.0	-1.5	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Central government											
Revenues	8.6	9.1	9.1	9.9	9.4	9.5	9.7	9.7	9.8	10.1	10.2
Of which:											
Tax revenues	7.9	8.7	8.8	9.2	8.7	8.8	9.0	9.0	9.1	9.4	9.5
Expenditures	9.5	9.3	10.1	11.5	10.8	10.8	10.9	10.7	10.9	10.8	10.8
Of which:											
Social and other new peace related	4.2	4.0	4.9	6.6	5.9	6.2	6.6	6.6	6.9	6.8	6.8
External sector											
Current account	-4.1	-2.8	-3.5	-4.0	-3.6	-3.4	-3.4	-3.2	-3.1	-2.7	-2.6
Of which:											
Exports, f.o.b.	14.8	14.3	14.6	14.7	14.8	15.2	15.6	15.5	15.4	15.3	15.0
Imports, c.i.f.	-22.5	-20.1	-21.4	-22.0	-21.6	-21.9	-22.1	-22.0	-21.7	-21.2	-20.7
Capital account	2.8	4.0	5.2	4.6	3.9	3.8	3.6	3.3	3.4	3.0	2.9
Official capital	-0.3	0.3	1.5	1.6	1.2	1.1	0.7	0.4	0.4	0.0	-0.1
Of which:											
Nonfinancial public sector	-0.2	0.1	2.0	1.4	1.0	0.8	0.6	0.4	0.3	-0.1	-0.2
Private sector	3.2	3.8	3.2	3.0	2.7	2.7	2.9	2.9	3.0	3.0	3.0

Source: Fund staff estimates.

Table 13. Guatemala: Medium-Term Projections
C. Fiscal Imbalance Scenario

	1995	1996	Prel. 1997	Projection							
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Real GDP growth	4.9	3.0	4.1	4.5	4.6	4.8	4.4	4.2	4.0	3.8	3.5
ICOR	3.1	4.2	3.4	3.2	3.3	3.3	3.4	3.3	3.4	3.6	3.6
Savings and Investment											
Gross domestic investment	15.1	12.6	14.1	14.4	15.3	15.6	15.2	14.0	13.5	13.5	12.5
Public	3.0	3.1	4.1	4.5	5.2	5.6	5.5	4.5	4.5	4.5	4.0
Private	12.1	9.5	10.0	9.9	10.1	10.0	9.7	9.5	9.0	9.0	8.5
National savings	11.0	9.8	10.6	10.4	9.7	9.8	9.7	9.5	9.5	9.8	9.8
Public	2.1	3.0	3.6	3.4	2.5	2.6	2.8	2.8	3.0	3.3	3.3
Private	8.9	6.8	7.0	7.0	7.2	7.2	6.9	6.7	6.5	6.5	6.5
Public sector											
Overall balance combined public sector	-0.9	-0.1	-0.5	-1.1	-2.7	-3.0	-2.7	-1.7	-1.5	-1.2	-0.7
Financing	0.9	0.1	0.5	1.1	2.7	3.0	2.7	1.7	1.5	1.2	0.7
External (net)	-0.2	0.1	2.0	1.4	0.8	0.7	0.6	0.4	0.3	-0.1	-0.2
Domestic (net)	1.1	0.0	-1.5	-0.3	1.9	2.3	2.1	1.3	1.2	1.3	0.9
Central government											
Revenues	8.6	9.1	9.1	9.9	9.4	9.5	9.7	9.7	9.8	10.1	10.2
Of which:											
Tax revenues	7.9	8.7	8.8	9.2	8.7	8.8	9.0	9.0	9.1	9.4	9.5
Expenditures	9.5	9.3	10.1	11.5	12.7	13.0	12.9	11.9	11.8	11.8	11.4
Of which:											
Social and other new peace related	4.2	4.0	4.9	6.6	7.7	8.2	7.9	7.4	7.1	7.0	6.8
External sector											
Current account	-4.1	-2.8	-3.5	-4.0	-5.6	-5.8	-5.5	-4.5	-4.0	-3.7	-2.7
Of which:											
Exports, f.o.b.	14.8	14.3	14.6	14.7	14.7	14.7	0.0	0.0	0.0	0.0	0.0
Imports, c.i.f.	-22.5	-20.1	-21.4	-22.0	-21.6	-21.5	0.0	0.0	0.0	0.0	0.0
Capital account	2.8	4.0	5.2	4.6	3.9	3.8	3.4	3.0	3.0	2.6	2.5
Official capital	-0.3	0.3	1.5	1.6	1.0	1.1	0.7	0.4	0.4	0.0	-0.1
Of which:											
Nonfinancial public sector	-0.2	0.1	2.0	1.4	0.8	0.7	0.6	0.4	0.3	-0.1	-0.2
Private sector	3.2	3.8	3.2	3.0	2.8	2.7	2.7	2.6	2.6	2.6	2.6
GAP 1/					-2.0	-2.4	-2.4	-1.6	-1.3	-1.4	-0.5
Memorandum items:											
New peace related expenditures 5/	0.0	0.0	0.9	2.6	3.7	4.2	3.9	3.4	3.1	3.0	2.8
New social-peace related expenditures 6/	0.0	0.0	0.9	2.5	3.7	4.2	3.9	3.4	3.0	2.8	2.5
Total social expenditures	4.2	4.0	4.9	6.5	7.7	8.2	7.9	7.4	7.0	6.8	6.5

Source: Fund staff estimates.

1/ Financing gap to keep gross reserves around 3 months of imports.

Table 14. Guatemala: Summary of External Debt Operations

	1991	1992	1993	1994	1995	1996	Est. 1997
(In millions of U.S. dollars)							
Outstanding debt 1/	2,344.1	2,281.3	2,248.1	2,405.9	2,347.7	2,379.9	2,620.2
Medium- and long-term debt	1,842.0	1,869.7	2,069.0	2,122.2	2,143.9	2,200.4	2,369.1
Public sector	1,247.6	1,270.5	1,315.0	1,440.4	1,507.9	1,581.9	1,820.8
Of which							
Bonds	0.0	0.0	40.0	40.3	38.3	39.4	189.4
CORFINA	204.1	205.0	385.3	383.8	379.1	378.8	377.8
Bank of Guatemala	390.4	394.3	368.6	298.0	256.9	239.7	170.5
Short-term debt	502.1	411.5	179.1	283.7	203.8	179.5	251.1
Public sector 2/	0.0	0.0	50.0	171.0	85.4	70.0	163.1
Bank of Guatemala	244.0	152.9	96.2	59.4	44.1	30.3	9.8
Arrears of interest 3/	258.1	258.6	32.9	53.3	74.3	79.2	78.2
Debt flows							
Drawings	147.6	195.2	191.8	435.7	158.4	139.5	415.6
Public sector 4/	83.3	47.3	157.9	267.8	123.4	91.5	385.6
Bank of Guatemala	64.3	49.9	33.9	8.5	0.0	0.0	0.0
BOP support	0.0	98.0	0.0	159.4	35.0	48.0	30.0
Scheduled debt obligations	258.8	314.2	287.7	344.6	313.8	278.8	265.1
Interest	122.4	137.3	110.1	121.8	119.8	129.5	90.0
Public sector 3/	76.2	71.3	60.9	76.4	74.9	88.7	74.2
CORFINA	0.0	16.6	17.3	20.9	20.3	20.2	0.03
Bank of Guatemala	46.2	49.4	31.9	24.5	24.6	20.6	15.8
Principal	136.4	176.9	177.6	222.8	194.0	149.3	175.1
Public sector 3/	71.4	81.1	102.3	151.6	139.2	101.7	88.1
CORFINA	0.0	19.7	15.1	7.8	2.3	1.7	2.0
Bank of Guatemala	65.0	76.1	60.2	63.4	52.5	45.9	85.0
Memorandum items							
Stock of arrears, end of period 3/	636.0	531.5	58.6	87.7	115.8	104.3	103.2
Interest	258.1	261.3	28.2	52.0	73.2	78.3	78.1
Principal	377.8	270.1	30.4	35.7	42.6	26.0	25.1
(In percent of GDP)							
Outstanding debt	25.1	22.0	19.9	18.6	16.1	15.2	14.7
Medium-term	19.7	18.0	18.3	16.4	14.7	14.0	13.3
Short-term	5.4	4.0	1.6	2.2	1.4	1.1	1.4
Of which							
Bank of Guatemala	6.9	6.3	3.6	2.7	2.3	2.0	1.4
Debt flows							
Drawings	1.6	1.9	1.7	3.4	1.1	0.9	2.3
Scheduled debt obligations	2.8	3.0	2.5	2.7	2.1	1.8	1.5
Interest	1.3	1.3	1.0	0.9	0.8	0.8	0.5
Principal	1.5	1.7	1.6	1.7	1.3	1.0	1.0
Memorandum items							
Stock of arrears, end of period	6.8	5.1	0.5	0.7	0.8	0.7	0.6
Interest	2.8	2.5	0.2	0.4	0.5	0.5	0.4
Principal	4.0	2.6	0.3	0.3	0.3	0.2	0.1
(In percent of exports of goods and nonfactor services)							
Total debt service	15.3	16.7	14.4	15.6	14.3	10.7	9.9
Interest	7.3	7.3	5.6	5.8	4.7	4.9	2.9
Principal	8.1	9.4	8.8	9.8	9.6	5.8	7.0

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

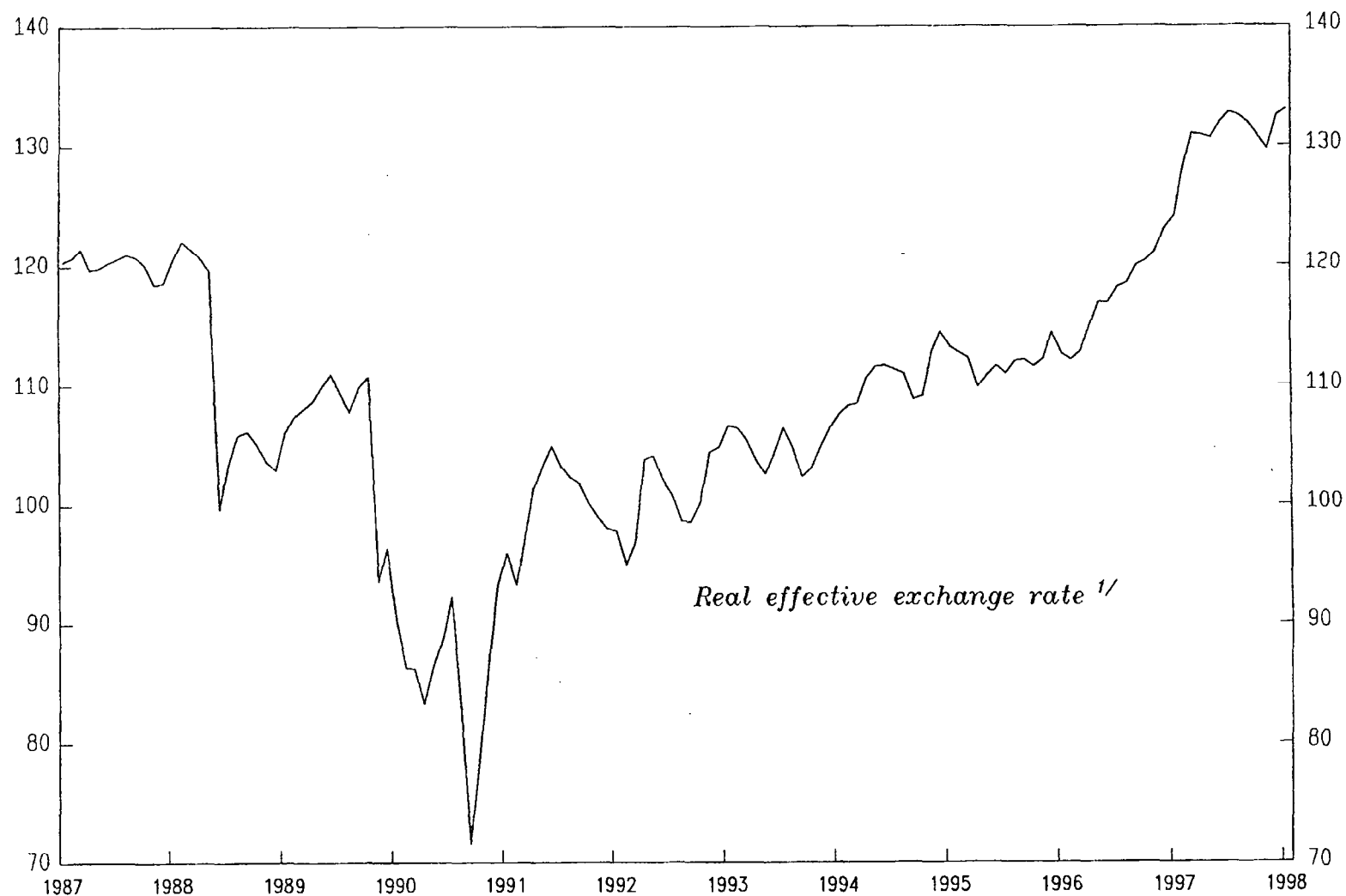
1/ Includes arrears and valuation adjustments.

2/ Includes bonded debt.

3/ Excludes arrears in grace period.

4/ Includes state financial institutions, except CORFINA and Bank of Guatemala.

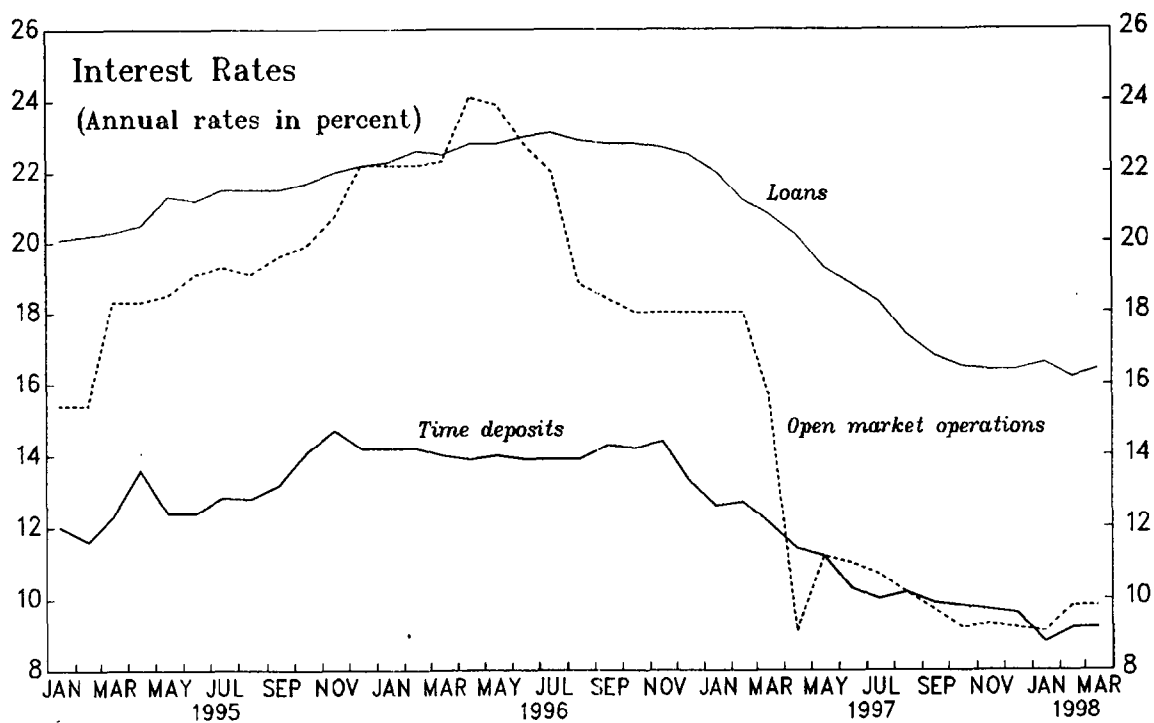
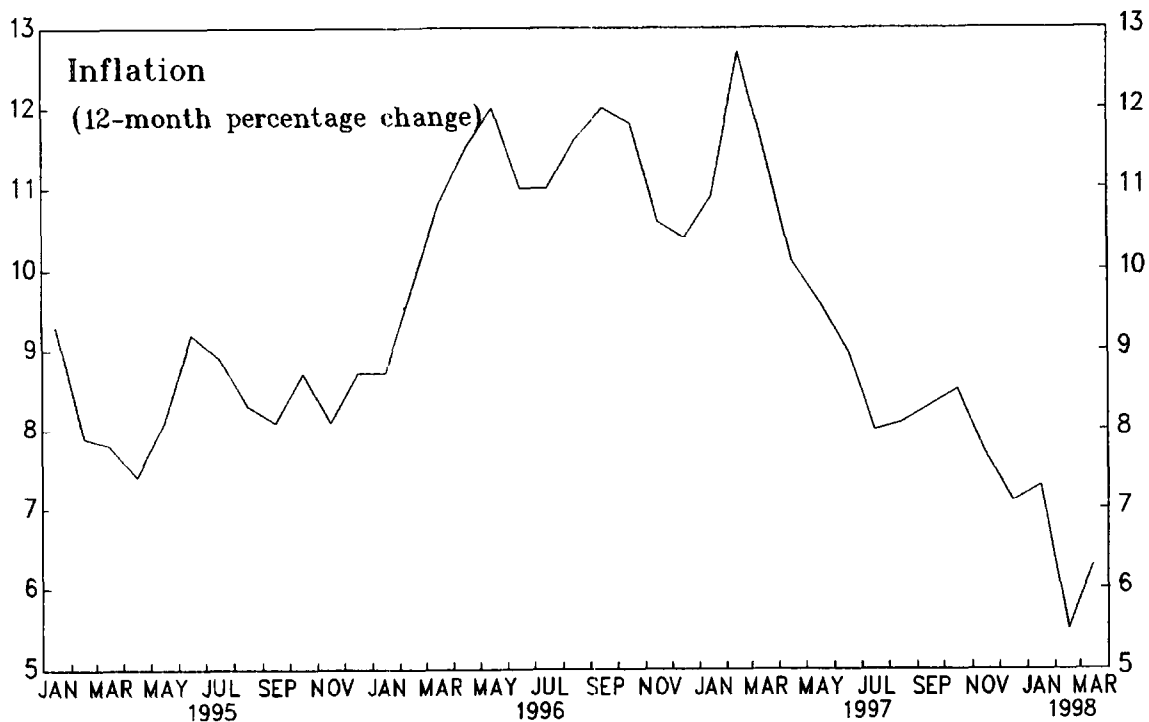
Figure 2. Guatemala:
Exchange Rate Developments
(1991=100)



Source: IMF Information Notice System.

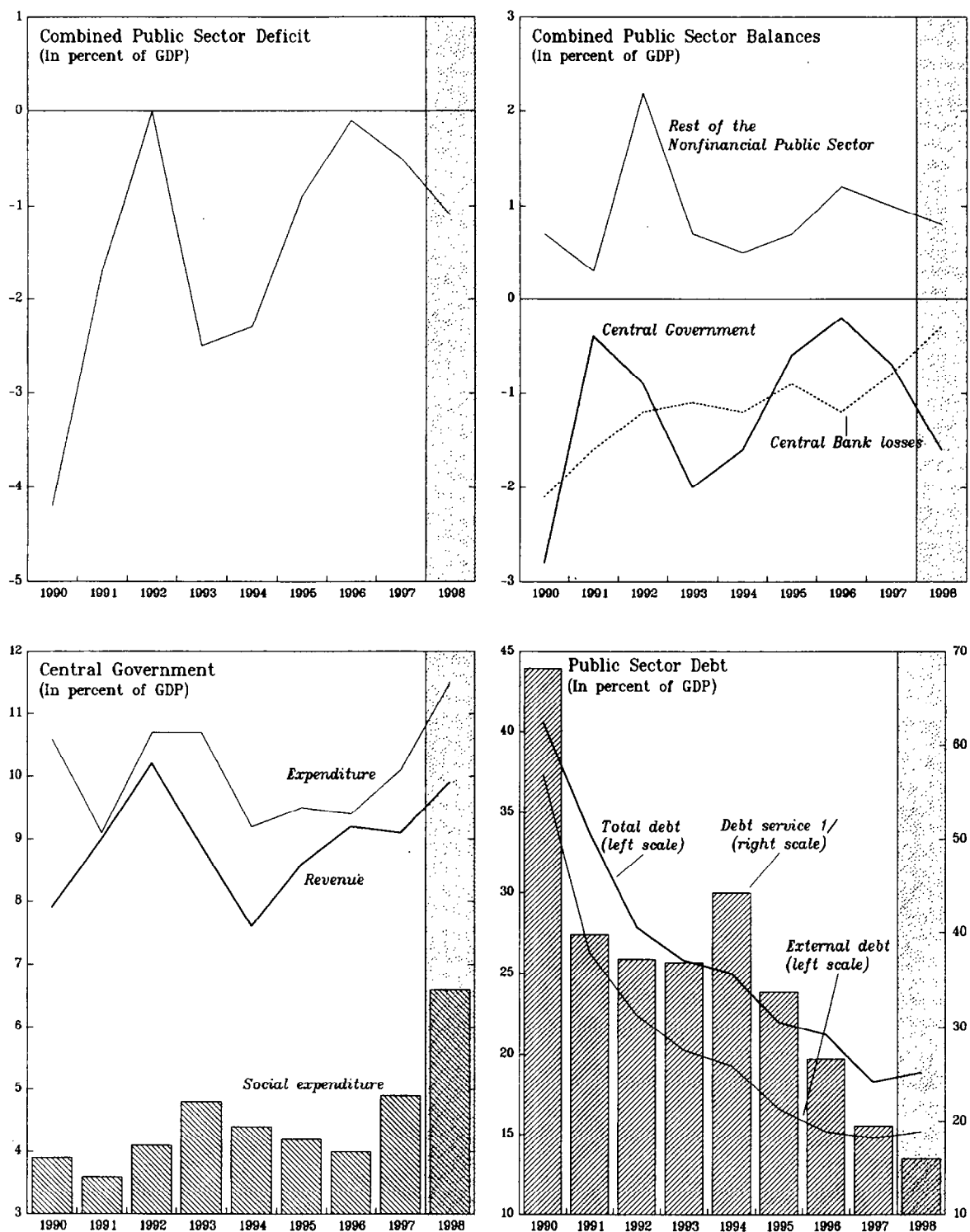
^{1/} An increase (decrease) indicates appreciation (depreciation).

Figure 3. Guatemala:
Inflation and Interest Rates



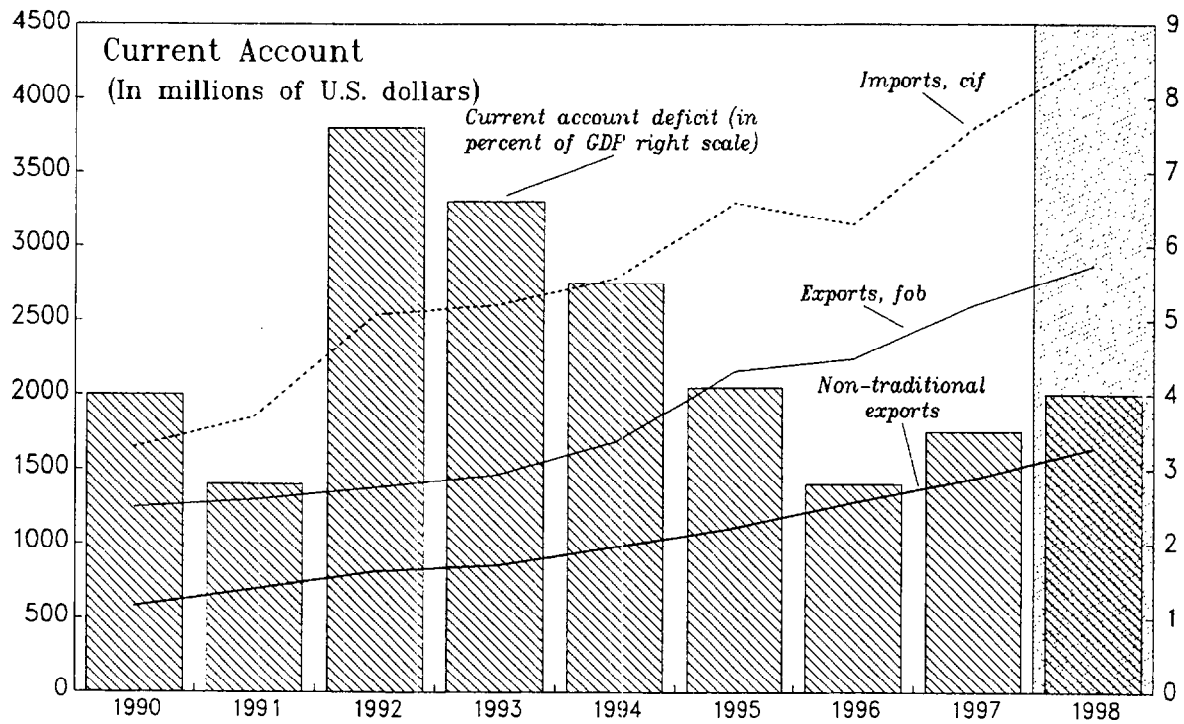
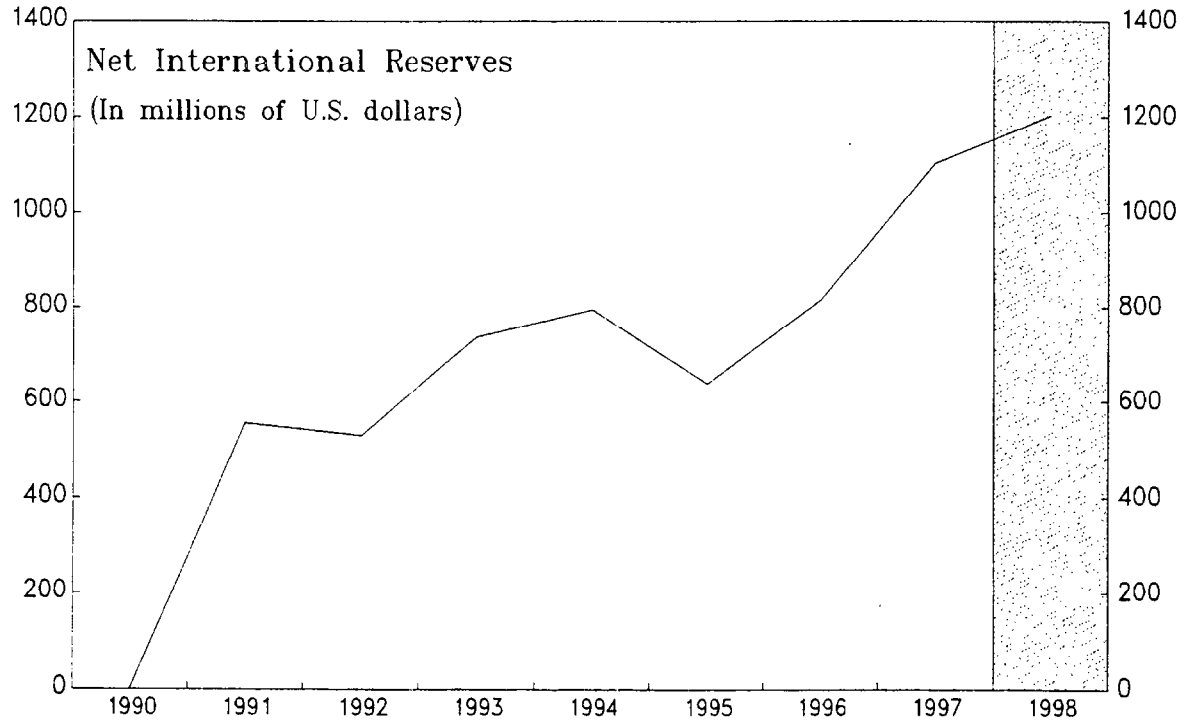
Source: Central Bank of Guatemala.

Figure 4. Guatemala:
Public Sector Indicators



Sources: Central Bank of Guatemala; and Fund staff estimates.

Figure 5. Guatemala:
External Sector Indicators



Sources: Central Bank of Guatemala; and Fund staff estimates.

Guatemala: Fund Relations
(As of March 31, 1998)

I. Membership Status:

Joined: December 28, 1945
Status: Article VIII

II. General Resources Account:	SDR Million	Percentage of Quota
Quota	153.80	100.00
Fund holdings of currency	153.81	100.00

III. SDR Department:	SDR Million	Percentage of Allocation
Net cumulative allocation	27.68	100.00
Holdings	9.24	33.4

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	12/18/92	03/17/94	54.00	0.00
Stand-by	10/26/88	02/28/90	54.00	23.16
Stand-by	08/31/83	12/31/84	114.75	57.38

VI. Projected Obligations to the Fund (SDR million; based on existing use of resources and present holdings of SDRs):¹

	Overdue	Forthcoming				
	03 /31/98	1998	1999	2000	2001	2002
Charges/interest	0.0	0.5	0.8	0.8	0.8	0.8
Total	0.0	0.5	0.8	0.8	0.8	0.8

¹The projection of charges and interest assumes that overdue principal at the report date (if any) will remain outstanding, but forthcoming obligations will be settled on time.

VII. Exchange Rate Arrangements

Since March 1994, the interbank foreign exchange market has been in operation, in which authorized financial institutions buy and sell foreign exchange at market-determined rates. Commercial banks, finance companies, and foreign exchange houses operate in the foreign exchange market, acting as agents of the central bank. The central bank intervenes in the market to avoid large exchange rate fluctuations as well as to purchase foreign exchange for meeting public sector external debt obligations. As of March 31, 1998, the exchange rate in the interbank market was 6.305 quetzales per U.S. dollar.

VIII. Last Article IV Consultation

The last Article IV consultation was concluded by the Executive Board on October 16, 1996 (EBM/96/93; the relevant documents were SM/96/243 and SM/96/247). Guatemala is on the standard 12-month consultation cycle.

IX. Technical Assistance

In 1994, MAE provided technical assistance on monetary management and the exchange system and FAD advised on tax policy and social safety nets. An MAE technical expert provided short-term assistance on commercial bank operations in 1995, and in prudential regulations on foreign exchange transactions in late 1996. During 1997, technical assistance was provided by MAE on banking soundness and prudential regulations, and FAD on tax policy and tax administration. Also, in 1997, a multisector mission by STA visited Guatemala to review statistical systems (including balance of payments, government finance, money and banking, national accounts and prices), and assisted the authorities in their consideration of the Fund's data dissemination initiatives.

X. Resident Representative

None.

Guatemala: Relations with the World Bank Group
(As of March 31, 1998)

I. FINANCIAL RELATIONS

A. IBRD/IDA/IFC Operations as of December 31, 1997

(In millions of U.S. dollars)

Sector	Disbursed	Undisbursed
Agriculture	4.0	0.0
Education/social sector	61.0	42.4
Power	194.8	canceled
<i>Of which</i>		
Chixoy	116.5	...
Urban development	37.1	...
Transportation	49.7	76.9
Telecommunications	69.2	0.0
Industry	16.8	0.0
Structural adjustment	120.0	0.0
Public sector modernization	4.9	61.4
Total	557.5	180.5
<i>Of which</i>		
Repaid	375.8	
Outstanding	174.7	
IFC investments	78.8	

B. IBRD/IDA/Loan Disbursements

	1991	1992	1993	1994	1995	1996	1997
Net disbursements	-16.8	-58.0	-38.7	-15.2	-26.2	55.9	-9.2
Gross disbursements	4.4	49.4	1.1	28.9	13.3	68.9	16.5
Amortization	21.2	107.4	39.8	44.1	39.5	13.0	25.7

Source: IBRD.

II. Recent Economic and Sector Work

The most recent reports on Guatemala include the "Implementation Completion Report of the Economic Modernization Loan" distributed to the Bank's Board of Directors on December 19, 1996 (Report No. 16181); the Country Economic Memorandum "Guatemala: Building Peace with Rapid and Equitable Growth" circulated to the Board on August 22, 1996 (Report No. 15352-GU); and the Public Investment Review "Guatemala: Investing and Peace" distributed to the Board in August 1997 (Report No. 16392-GU). In 1996, the Bank did not authorize new loans for Guatemala, but in 1997 the Board of Directors approved five loans: three technical assistance loans on "Private Participation in Infrastructure," "Tax Administration Reform," and "Integrated Financial Management Loan II;" and two investment loans for "Basic Education Reform," and "Rural and Main Roads." The Bank is preparing operations in the areas of judicial reform, expansion of the land market (cadastre and land management), development of low income neighborhoods with FONAPAZ, and expansion of the operations of the Social Investment Fund. It is also considering a second adjustment operation to support the authorities' peace reinsertion program and post-conflict expenditure shifting initiatives. Forthcoming sector work is scheduled in the areas of peace programs, rural credit, financial sector vulnerability, public expenditure, fiscal revenues, and a possible living standard measurement study (focused in selected regions).

Guatemala: Relations with the Inter-American Development Bank
(As of March 31, 1998)

I. IDB Current Portfolio as of December 31, 1997
(In millions of U.S. dollars)

Sector	Approved	Undisbursed
Social sectors	320.0	258.6
Community development	180.0	118.9
Credit to micro-enterprises	10.0	10.0
Environment	54.6	54.6
Housing	60.0	60.0
Education	15.4	15.4
Physical infrastructure	150.0	106.5
Reform loans	147.7	105.5
Infrastructure and investment	107.6	77.6
Health	38.6	26.6
Customs	1.4	1.3
Total	617.6	470.6

I. IDB LOAN DISBURSEMENTS

	1991	1992	1993	1994	1995	1996	1997
Disbursements	50.2	18.3	23.1	114.1	42.8	37.3	96.9
Amortization	77.2	26.8	29.1	33.3	36.2	47.1	42.6
Interest and charges	42.3	27.5	29.1	29.4	30.0	35.0	30.0
Net cash flow	-70.3	-36.0	-35.9	50.2	-24.7	-47.4	22.9

II. RECENT ECONOMIC AND SECTOR MISSIONS

The most recent economic report on Guatemala (country paper) was distributed to the IDB's Board of Directors in October 1996 (Report No. GN-1924-1). Outlined in this document, the Bank's strategy focuses on four points: inclusion of the poor, indigenous, and rural populations; expansion and improvement of social services; modernization of the state; and development of private production sectors. In 1996, the IDB approved loans for Peace Consolidation (US\$50 million), for the Social Investment Fund (US\$42 million), for improving Guatemala City environment (US\$35 million), and for fostering the sustainable development of Peten (US\$20 million). In 1997, the Bank approved an infrastructure and investment sector loan (US\$107 million) aimed at facilitating the privatization process, particularly in the areas of telecommunications, energy, civil aviation, and hydrocarbons, a loan (US\$60 million) to provide housing for low-income people, and an education loan (US\$15.4 million). The Bank is preparing for 1998 operations aiming at judicial reform, financial reform, pre-investment for peace, environment and productive agricultural activities. For 1999 and 2000, the Bank is preparing operations to support credit for small and medium enterprises, road modernization, and reforms in the areas of health, education, and pension. The operations tentatively scheduled for approval in 1998 amount about US\$200 million, and the total for 1998-2000 amount between US\$700 million and US\$900 million.

III. TENTATIVE SCHEDULE OF DISBURSEMENTS

	1998	1999	2000	2001	2002
Disbursements	146.8	147.4	187.7	189.6	194.0
Amortization	51.3	41.6	44.1	37.2	37.7
Interest and charges	34.8	41.2	49.9	60.0	70.4
Net cash flow	60.7	64.6	93.6	92.4	85.9

Guatemala: Statistical Issues

In general, the quality, coverage, and timeliness of Guatemala's statistical information permit a reasonable monitoring of economic developments. The authorities are usually very cooperative in providing data to the Fund in a timely fashion, in some cases on a daily basis (see the Core Statistical Indicators). However, recently, important delays have emerged related to government statistics. In addition, there are important deficiencies in the area of national accounts and prices, and in the information on public finances. The authorities are addressing some problems in national accounts, monetary accounts, and balance of payments statistics, in line with the recommendations of the STA multisector mission in 1997.

National accounts statistics

Guatemala's national accounts are produced by the central bank based on the 1953 U.N. System of National Accounts methodology and using 1958 as the base year. National accounts statistics are limited in coverage to calculations of (1) GDP at constant (1958) prices by sector of origin, and (2) GDP at both constant and current prices by final demand components. Data are published annually with preliminary results available with a lag of about three months. With the assistance of a U.N. statistical advisor, the central bank is implementing the 1993 SNA methodology and changing the base year to 1995. STA provided technical assistance in July–August 1997, and a follow-up mission on national accounts during January 1998 reviewed progress in implementing the 1993 SNA methodology. Further assistance from STA is planned. Guatemala's CPI uses weights based on consumer expenditure surveys undertaken in 1979 and 1981. Data are published monthly by the National Statistics Institute which is the organization that produces the series. The introduction of new CPI weights based on consumer expenditure surveys to be conducted in 1998 and 1999 is in process.

Monetary authorities

Monetary authorities' data are being compiled on a monthly basis and sent regularly to the Fund for publication in IFS. In January 1995, the Superintendency of Banks introduced a new accounting system for commercial banks and nonbank institutions. Monthly monetary data for commercial banks and other banking institutions are sent to the Fund for publication in IFS. The Bank of Guatemala has received technical assistance from the Fund to improve the compilation of data for the banking system, and the authorities are implementing these recommendations.

Government finance statistics

There are recurrent problems in reconciling the fiscal balance from above the line with the information on financing flows. More recently, the lag in the reporting of statistics on revenue and expenditure of the central government has increased and significant corrections to

preliminary figures lack substantiation. Overall public sector statistics are not compiled on a regular basis by the Ministry of Finance because data on revenues and expenditure of the major public enterprises (INDE and GUATEL) and the Social Security Institute (IGSS) are available with long lags. While progress has been made in adopting the new accounting framework for the budget, little work has been made in improving statistics of the social security and public enterprises.

Balance of payments

The balance of payments statistics are based on the reports of foreign exchange transactions of commercial banks and custom documents, and they follow the methodological guidelines of the outdated fourth edition of the balance of payments manual. Thus, the coverage of the balance of payments statistics is incomplete, especially for financial accounts. Additionally, there is no information on portfolio investment transactions, and there are considerable delays in reporting actual data. The authorities are implementing the recommendations of the 1997 STA mission and the methodology of the fifth revision of the balance of payments manual. It is expected that the balance of payments statistics for 1998 will be estimated following these guidelines.

Guatemala: Core Statistical Indicators

as of March 31, 1998

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Debt/ Debt Service
Date of Latest Observation	03/27/98	03/27/98	03/12/98	03/12/98	02/98	03/27/98	03/20/98	12/97	12/97	12/97	1997	1997
Date Received	03/30/98	03/30/98	03/20/98	03/20/98	03/98	03/30/98	03/30/98	03/10/98	03/10/98	02/03/98	02/98	03/10/98
Frequency of Data	D	D	W	W	M	W	W	M	Q	M	A	A
Frequency of Reporting 1/	D	D	W	W	M	W	W	O	O	M	A	A
Source of Update 2/	A	A	A	A	A	A	A	A	A	A	A	A
Mode of Reporting 3/	E, C	E, C	C	C	C	C	C	C	C	C	C,E	C,V
Confidentiality 4/	C	D	D	D	D	C	C	D	D	D	C	D
Frequency of Publication 1/	D	Q	Q	Q	Q	D	M	Q	A	A	A	A

1/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annual, or O-other (only when requested).

2/ A-direct reporting by central bank, or ministry of finance.

3/ E-electronic data transfer, C-cable of facsimile, T-telephone, M-mail, V-staff visits, or O-other.

4/ (A) for use by the staff only, (B) for use by the staff and the Executive Board, (C) for unrestricted use, (D) embargoed for a specified period and are thereafter for unrestricted use, or (E) subject to other use restrictions.

