April 10, 2020
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/47-2

11:00 a.m., May 25, 2018

2. Guatemala—2018 Article IV Consultation

Documents: SM/18/106 and Correction 1, and Supplement 1, and Supplement 1, Correction 1; SM/18/107; and Correction 1, and Correction 2

Staff: Perez Ruiz, WHD, Murgasova, SPR

Length: 47 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
	E. Sishi (AE), Temporary
	H. Razafindramanana (AF)
	B. Lischinsky (AG), Temporary
	M. Kikiolo (AP), Temporary
	P. Fachada (BR)
	X. Cai (CC), Temporary
	A. Del Cid-Bonilla (CE), Temporary
	N. Feerick (CO), Temporary
	C. Just (EC)
	C. Rebillard (FF), Temporary
	K. Merk (GR)
	M. Siriwardana (IN)
A. Leipold (IT)	
	T. Ozaki (JA), Temporary
	K. Badsi (MD), Temporary
	M. Merhi (MI), Temporary
	V. Rashkovan (NE)
	K. Virolainen (NO)
	A. Tolstikov (RU), Temporary
	F. Rawah (SA), Temporary
	E. Villa (ST)
	P. Inderbinen (SZ)
	O. Haydon (UK), Temporary
M. Claver-Carone (US)	

C. McDonald, Acting Secretary
S. Kalra, Summing Up Officer
J. Acheson / V. Sola, Board Operations Officers
M. McKenzie, Verbatim Reporting Officer

Also Present
Legal Department: Y. Esquivel Soto, N. Kyriakos-Saad. Strategy, Policy, and Review Department: Z. Murgasova. World Bank Group: F. Koehler-Geib. Western Hemisphere Department: N. Chalk, V. Flamini, R. Garcia-Saltos, C. Janada, E. Perez Ruiz, J. Sin.

Senior Advisors to Executive Directors: V. Djokovic (SZ), B. Varga (EC). Advisors to Executive Directors: P. Braeuer (GR), M. Coronel (BR), P. Di Lorenzo (IT), O. Diakite (AF), T. Gade (NO), S. Ismail (ST), M. Josic (NE), M. Svenstrup (US), J. Montero (CE).

4. GUATEMALA—2018 ARTICLE IV CONSULTATION

Mr. Hurtado and Mrs. Del Cid-Bonilla submitted the following statement:

The Guatemalan Authorities would like to thank the staff for the candid dialogue during the 2017 Article IV consultation and for the set of reports produced, particularly the selected issues papers, which they find very useful and opportune. While authorities broadly agree with the staff assessment, we would like to emphasize the following topics:

Economic Resilience and Growth

Guatemala has a solid track record of macroeconomic stability and strong resilience. This is reflected in steady rates of economic growth, stable exchange rate and interest rates, low and stable inflation, low fiscal deficits, a solid, solvent and liquid banking system, and low levels of public debt (at 24 percent of GDP, Guatemalan public debt is one of the lowest in the region, remains stable and has an historical strong record of payment). Disciplined macroeconomic and financial policies have contributed to the economy's strong resilience to different shocks both external and domestic. In this context; economic growth averaged 3.5 percent since 2007. The economy slightly decelerated to 2.8 percent in 2017, but official projections point out to a recovery of 3.4 percent in 2018, driven by the expected higher economic growth in the United States, which would lead to an increase in exports, and a recovery in internal demand, in particular public investment. The authorities concur with staff that the economy needs to grow faster in order to create more jobs, increase per-capita income and, consequently, contribute to reduce poverty; the robust economic fundamentals described are solid basis to underpin growth and investment.

Monetary and Exchange Rate Policies

Inflation has been within the target range during the last eight years, and monetary policy has been accommodative over the past three years. The policy rate was cut by 100 basis points in 2015 (from 4 percent to 3 percent), taking into account that inflation was on target, inflationary expectations were anchored, economy was decelerating, and fiscal policy was pro-cyclical. The policy rate remained unchanged until November 2017, when the monetary authorities approved an additional cut of 25 basis points. The current policy rate (2.75 percent) is well below the authorities' estimation of neutral interest rate, negative in real terms, and one of the lowest among the Latin American countries under the inflation targeting regime.

From a forward-looking standpoint, the authorities see limited space for additional monetary policy accommodation. Liquidity is ample in the banking system, the output gap, although still negative, is closing, and core inflation is expected to accelerate; moreover, fiscal budget execution is expected to improve this year and credit to accelerate, which would create upward demand pressures on inflation, albeit moderate. In addition, on the external front, risks to higher inflation may arise from increases in oil prices, while the normalization of the U.S. monetary policy would make it unwise additional policy rate cuts. That said, as customary, the monetary authorities will opportunely take the necessary measures to keep inflation on target, based on the assessment of a comprehensive balance of inflation risks steaming from both the external and domestic economic conditions.

The authorities do not share the reclassification of the de-facto exchange rate arrangement from floating to stabilized. Consistent with the Inflation Targeting Regime, the exchange rate (ER) is flexible given that market supply and demand are the main determinants in the FX market. A clear and transparent rule for central bank's intervention has been in place for more than 10 years; the central bank's objective is to intervene only to smooth volatility without changing the ER trend, as evidence has demonstrated. That said, the authorities have made clear their commitment to a more flexible exchange rate by gradually increasing the margin of the afore mentioned rule.

Financial System

Guatemala's financial system is one of the more solids and excels in the fight against money laundering. The soundness of the banking system ranks 11 among 137 countries assessed, according to the global competitiveness index published by the World Economic Forum in its 2017-2018 report, improving consistently since 2015. According to the Mutual Evaluation Report of the Republic of Guatemala performed in 2016 by the Latin American financial action group (GAFILAT), the country ranks among the first ten in world comparison in the areas of technical compliance and effectiveness in AML/CFT (this ranking was published by the Basel Institute on Governance in August 2017). With support from the Fund and GAFILAT, a revision of the law is underway to strengthen the AML/CFT framework, and is expected to be completed during the second semester of this year.

The authorities continue efforts oriented to improve financial inclusion. Guatemala ranks 20 in the getting credit category of the Doing

Business 2018 report. The Law of Factoring and Discounts Contracts was approved last January and in April Congress approved reforms to the Law of Movable Guarantees. A law initiative to give the leasing financial mechanism the appropriate legal framework is pending Congress approval.

Fiscal Policy

Efforts to enhance tax administration and transparency have continued. A law for strengthening fiscal transparency and the governance of the Superitendency of Tax Administration (SAT) was passed in August 2016. The law aims to reform the organizational structure of the SAT to incorporate mechanisms that contribute to achieving its objectives, including the necessary operational resources for its functioning. Since the law enactment, the tax administration has successfully aligned the following transversal axes of its policies: i) transparency and tackling corruption; ii) increase institutional efficiency, increase cooperation, fiscal audit and tackling evasion; iii) provide better service to taxpayers; and iv) use of technology and personal development. The government has continued enhancing transparency through the open budget exercise; in addition, a new Vice-Ministry of Finance in charge of Transparency was established for institutional strengthening and transparency in the management of public resources and the implementation of the Procurement Law, as well as for technical and technological assistance. An anti-smuggling law is pending approval by Congress.

The authorities are aware of the need to promote deeper reforms to increase revenue mobilization that will allow increasing social and capital expenditures. They consider that a comprehensive reform is needed to stand more political viability. The reform should include measures to increase the quality and efficiency of spending, keep transparency of procurement processes while enhancing their efficiency, reform the civil service and broaden the tax base. Additional revenues coming from tax policy changes should aim to finance visible and high impact spending programs.

Programs with the highest potential to reduce poverty and inequity, linked to the Sustainable Development Objectives (SDO), are being identified with support from the WB and the IMF. The authorities are looking for effective and focalized investment mechanisms, and innovative execution schemes for a successful implementation. The General Road Infrastructure Law initiative, presented to Congress on April 2018, is under assessment by the corresponding commission. The authorities share staff's view on the need to push other reforms such as one in the Comptroller General's Office that can help to accelerate budget execution.

In June 2017, Congress ratified the Convention on Mutual Administrative Assistance in Tax Matters. The Convention is an instrument available for all forms of tax cooperation to tackle tax evasion and avoidance, a top priority for all countries, it was amended to respond to the G20 call at its 2009 London Summit to align the instrument to international standards on exchange of information on tax and customs matters on request and to open it to all countries, in particular, to ensure that developing countries could benefit from the new transparent environment.

Policies to Foster Growth and Employment

The government's policy to foster growth and investment comprise four pillars and three transversal axes. The four pillars are i) trade and local and foreign investment; ii) financial access and entrepreneurship; iii) productive infrastructure and orderly urbanization; and iv) competitiveness and formal employment. Legal certainty, governance and macroeconomic stability are the transversal axes of this policy.

Efforts for the implementation of the Northern Triangle Prosperity Alliance Plan are ongoing. Inter-institutional and multi-sectorial coordination is carried-out by the Ministry of Economy (through the National Competitiveness Program -PRONACOM-). Guatemala is currently implementing the plan in 51 municipalities, of which 41 have been identified as having critical needs for socio-economic development

A number of reforms are being promoted to improve the business climate. Reforms to the Commercial Code were approved in 2017, including reducing the amount of initial capital to start a business; also, to expedite the process for the issuance of construction licenses, state authorities plan to implement a project to open the Single Window for Construction Licenses by end May.

The Competition Law is currently in the last stage of approval. Proposed amendments need to be considered at this stage. The Congress' Commission of Economy and Foreign Trade, in coordination with the Ministry of Economy and PRONACOM, with the support of the Competition Rights Institute, has organized a series of public presentations on the challenges and impacts of this initiative.

A law initiative that provides the legal framework for the Consultation of Indigenous Peoples, in accordance with Convention 169 of the International Labor Organization is under consideration by Congress. This initiative seeks balance between reducing uncertainty related to investments in the extractive sector, and protecting indigenous peoples' rights. The initiative has been passed to the work commission for assessment.

Governance

As staff pointed out in the SIP, Guatemala continues making significant efforts to fight corruption. Guatemala has changed its institutional status quo since 2015 and it is expected that soon it will arrive at a new and more favorable equilibrium. As it is well known, during 2015-2018, the General Prosecutor's Office (MP) and the International Commission Against Impunity in Guatemala (CICIG) have unveiled several high-impact cases of corruption that led to the detention and trial of high level individuals, both from public and private sectors. The transparency of the recent election process for the new general prosecutor was recognized at national level and by the international community. Several laws have been approved to strengthen the judicial system and there are others being discussed: reform to the organic law of the public ministry (approved in March 2016); law of the judicial career (approved in July 2016 and reformed in October 2017).

The Financial Intelligence Unit (IVE) continue to strengthen its capacity and analytical skills to conduct financial analysis and enforce compliance with the AML/CFT regulations. As a result, suspicious transactions reports, IVE requirements, and national reporting requirements overseen by IVE, among others, have increased dramatically over the past 5 years, as summarized in Table 1 page 42 of the SIP.

Mr. Rashkovan and Mr. Josic submitted the following statement:

We thank staff for comprehensive set of reports and Mr. Hurtado and Mrs. Del Cid-Bonilla for their helpful buff statement. Despite political uncertainty, the Guatemalan economy showed resilience with solid economic growth, well anchored inflation, prudent fiscal policy and a robust financial system. However, poverty, social inequality and governance issues prevent unlocking the full potential of the Guatemalan economy in the medium-term. We broadly agree with staff's appraisal and provide the comments below for emphasis.

Poverty remains pervasive and inequality is high. According to the latest UNDP reports, Guatemala's ranking on the Global Human Development Index is lower than the average for Latin America and the Caribbean, with relatively little progress with reducing poverty since 2012. The average years of schooling is below the overall median, and almost 2 years less than in peer countries. In addition, poverty and extreme poverty, at 60 and 23 percent of population respectively, are amongst the highest in the region and have been increasing over the last decade, as highlighted by staff. We therefore encourage the authorities to improve access to basic utility services and education and increase the efficiency of social spending to tackle poverty and achieve progress on the Sustainable Developments Goals agenda. Addressing informalities in labor markets and ensuring that salaries are not paid below the minimum wage should be part of the reform package.

Revenue mobilization and improvements in tax administration should be at the core of the overall improvement in the public financial management. We welcome the authorities' efforts to improve the tax audit efficiency and minimize tax evasion. At the same time, we regret that the 2016 tax reform in line with staff recommendations has not passed because of lack of political support. We urge the authorities to continue with revenue mobilization to at least 15 percent of GDP, to remove all unnecessary tax exemptions and to reduce the high level of revenue earmarking. On the expenditure side, containing the wage bill and recurrent expenditures pertaining to elections, while increasing the efficiency of expenditures is of utmost importance. It would allow higher spending on education, health and public infrastructure which are both of a critical need and essential to boost the potential growth. This would also be in line with staff's assessment of substantial fiscal space to accommodate such higher spending. Could staff provide more information on the status of 2018 budget and the dispute for mining company.

It seems that there is a disagreement between staff and the authorities on the estimate of the real exchange rate. The staff estimates an undervaluation of 15 percent, compared to the authorities' assessment of the aligned real exchange rate. Could staff clarify the divergence in these estimates? In addition, the authorities do not agree with the reclassification of the de facto exchange rate arrangement from "floating" to "stabilized." While we can see merit in reclassification per se, did staff consider a "crawl-like" arrangement, taking into account that the nominal exchange rate (quetzals per U.S. dollar) has a long trend of appreciation in an almost monotonic and continuous manner? Lastly, since the authorities indicated their commitment to reduce FX interventions, does staff plan to reclassify the exchange rate arrangement again if volatility exceeds the 2 percent threshold?

Improvements in governance and the business environment continue to be crucial. We commend the authorities for the anti-corruption efforts implemented since the 2015 political crises. At the same time, we encourage the authorities to step up the judicial reform, as well as to strengthen contract enforcement and protection of minority investors, which would further boost confidence and increase private sector investments. A stronger AML/CTF framework would also support efforts against corruption.

Lastly, the Joint Management Action Plan (JMAP) presented in the Informational Annex provides a detailed and accurate overview of measures needed to be implemented in Guatemala. We recommend the authorities to leverage on the knowledge and experience of the WB and the IMF and follow up and implement this joint plan in a timely manner. Mr. Hurtado and Mrs. Del Cid-Bonilla's buff statement is encouraging and shares optimism that political stability will prevail and that the ambitious reform agenda will be implemented to the benefit of all Guatemalan people.

With these remarks, we wish the authorities the best in their future endeavors.

Mr. Virolainen and Mr. Gade submitted the following statement:

We thank staff for the set of well-crafted reports, and Mr. Hurtado and Mrs. Del Cid-Bonilla for their informative buff statement. The reports contain relevant policy advice for the Guatemalan authorities, but can also be read in a broader perspective, providing valuable input more generally on the processes, measures, and impacts of strengthening governance, as well as economic policies, to lift the long-term growth potential and more people out of poverty. For the medium-term, strengthening such policies are important not only in Guatemala, but also elsewhere, to lift the long-term growth potential and to raise living standards for all. The staff is thus making an important contribution with this report, where we broadly agree with the staff appraisal. We wish to make the following points for emphasis.

We broadly agree with staff's assessment on the needed policy mix. Given the growth slowdown, a negative output gap, low automatic stabilizers, and sound fiscal balances, we see merit in staff's proposal to let temporary higher spending support demand, and let monetary policy react accommodative, if inflation is assessed to fall below target. However, as staff also points out, such spending should be centred on high-impact programs in pursuit of the Sustainable Development Goals, which are lagging and need funding in the medium-term.

Medium-term fiscal spending expansion should be accompanied by a comprehensive tax reform to increase revenue through higher progression and base broadening. We support staff's recommendation of a comprehensive tax reform through tax administration efforts and tax policy changes. The report outlines many good policy options on PIT rates, simplification of corporate income tax, higher indirect taxes, and fewer tax exemptions. As a general point, we think priority should also be given to allow for greater progressivity in the tax system, as some of the proposal are regressive, and not to rely only on creating overall progressivity via the spending side through social spending. We welcome technical assistance to Guatemala to assist in this important process of comprehensive tax reform.

Generating sufficient revenue is important for Guatemala to achieve the required funding to meet the Sustainable Development Goals (SDG). Formulating high-impact SDG projects and strengthening execution is important. The report gives a concerning impression, as staff assess that the costing of interventions needed to close the development gaps, and the associated revenue mobilization strategies to fund such spending, remain largely unaddressed. Combined with the assessment that key reforms are likely to be held back until after the presidential elections next year, we encourage the authorities to pursue the SDGs more forcefully, and to aim for reform efforts that can garner broad-based political support.

We strongly support the ongoing fight against corruption and reduced informality in the economy. A strong anti-corruption effort is absolutely necessary for any deeper policy reform. While there are broad-based anti-corruption efforts underway, political support for this process, and for the CICIG, should continue, to also reduce any political tensions and uncertainties. Consideration should be given to strengthen judicial capacities, to reducing the backlog, and to strengthening legal certainty. While not linked to corruption, we also see merit in staff's focus on reducing the informality in the labor market, and in staff's proposal on lowering the minimum wage to regional peers, as a mechanism to reduce informality.

On the External Balance Assessment, we are somewhat concerned about the mechanical assessment of the REER undervaluation. While we are generally supportive of the External Balance Assessment framework, we are concerned that the translation of the Current Account gap into a valuation of the REER is too mechanistic. As it is not accompanied by other metrics in this report, and the authorities have a different assessment, the use of ranges could be more appropriate, given the uncertainty associated with such an assessment.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the detailed reports and Mr. Hurtado and Mrs. Del Cid-Bonilla for their informative buff statement.

We commend the Guatemalan authorities for maintaining macroeconomic stability relatively well over the past many years. The country has maintained an average growth of around 3.5 percent since 2007. However, this stable economic growth has not been able to meaningfully raise living standards of the Guatemalan people, as reflected by poverty rates, which are among the highest in the world, significantly high income inequality and chronic malnutrition in the country. Hence, we note the pressing need of raising investment in physical and social capital to spur high and inclusive growth, ensure social cohesion and lift living standards, and urge the authorities to continue vigorous efforts with prudence while preserving macroeconomic stability. We broadly agree with the thrust of staff's appraisal and recommendations, and would like to make following comments for emphasis.

Revenue-based fiscal consolidation is vital to secure adequate fiscal space towards supporting the increase of production capacity. The low budget deficits and debt levels reaffirm the authorities' commitment to a strong fiscal discipline. However, in the recent past, lower deficits have been mainly achieved at the expense of social spending, transfers and capital spending. The staff's comments are welcome on the possibility of further cuts in expenditures. We note the ongoing measures to improve the execution of spending. On the revenue side, strong efforts, buttressed by enhancing tax base, reducing tax expenditures and combating tax evasion through reinforcing tax administration efforts, are essential to enhance revenue. Hence, we broadly agree with the 2016 tax reforms and the non-approval of those reforms is a matter of concern. With one of the lowest tax levels in the region, we see merit in implementing the reforms, including the raising of income tax and VAT rates, in pursuit of a more progressive tax system. Hence, we urge the authorities to move forward by implementing tax reforms to rectify the present situation. In the absence of the proposed package and in view of upcoming elections, staff comments are welcome on potential alternative measures to generate additional revenue in the medium-term.

The accommodative monetary policy stance seems appropriate. Inflation has remained within the target range for the last eight years. We note the authorities' view that there is limited space for additional monetary policy accommodation going forward. Continued improvements to the monetary policy framework are also required to improve its effectiveness. We agree with staff that monetary transmission should be further improved through deepening the debt market, optimizing monetary policy instruments and discouraging dollarization of credit. The inflation targeting framework will also benefit from allowing greater exchange rate flexibility.

Financial system soundness indicators are favourable and NPLs are low, but reform efforts to strengthen the resilience of the financial system should be continued. The authorities should implement the Basel III standards gradually to reinforce capital and liquidity, and enhance financial deepening. We support the new banking law to strengthen the bank resolution framework and depositor protection. The anti-corruption measures adopted after the 2015 political crisis are appreciated and we see the criticality of sustained government support to reinforce good governance and support the proposed broader measures related to this. We encourage the authorities to further strengthen the AML/CFT framework to address corruption and organized crimes. The staff's comments on the extent of organized crimes and their potential impact on the overall economic performance are welcome.

Achieving inclusive growth is crucial to meet social challenges related to poverty and inequality. Addressing infrastructure deficiencies through enhancing capital investments has been identified as a key impediment to growth, which reinforces the need for domestic revenue mobilization to spend on high-impact projects. We commend the authorities for embracing SDGs as part of the national development strategy. However, this needs channelling adequate resources and effective implementation of related projects to meet desired objectives. Continued investment in social programs and human capital development is essential to improve skills and productivity of labor force, particularly to create opportunities for vulnerable groups. Improving competition while addressing security concerns is also vital to improve the business climate and stimulate investment. In this context, we encourage the authorities to pass the proposed Competition Law without further delay.

With these comments, we wish Guatemalan authorities all success in their future endeavours.

Mr. Merk and Mr. Maluck submitted the following statement:

We thank staff for the set of informative reports and Mr. Hurtado and Mrs. Del Cid-Bonilla for their helpful buff statement.

We broadly concur with the staff's assessment. We welcome that Guatemala's macroeconomic framework preserved stability through a severe political crisis. Nevertheless, this crisis has taken a toll to the outlook by weakening confidence and diminishing prospects for urgently needed structural reforms.

We consider raising revenues and spending efficiency a crucial part of the fiscal package to enable authorities to reverse the downward trend in investment. We take positive note of a solid track record of a prudent fiscal policy and of staff's assessment that central government debt is sustainable in the medium and long term. Having said this, we highlight staff's assessment that additional revenues of around 3.5 percent of GDP will be needed to fulfill basic public policy functions. We encourage the authorities to follow Fund's advice to improve tax administration, tax reforms, and spending efficiency to create room for policies that would lift more Guatemalans out of poverty and pursue the Sustainable Development Goals. The development of a medium-term budget framework can be helpful and the effective coordination between different Ministries is crucial in this regard. Concerning the wage-bill in the public sector, reforms of the salary system as well as a comprehensive assessment of the current structure of public employment through the ongoing public-sector personnel census are key.

We agree with staff's structural assessment of monetary policy. We highlight the need to strengthen the inflation targeting framework and second staff in their call for allowing the exchange rate to play a greater role as an adjustment mechanism. On staff's advice regarding the monetary policy stance, we would like to hear from staff if they see any potential financial stability risks of a potentially lowered policy rate in the future. To further strengthen financial sector resilience, we encourage the authorities in line with staff's recommendation to gradually move toward Basel III standards and strengthen the bank resolution framework. Moreover, a stronger AML/CFT framework will be key to support efforts against corruption and organized crime and the revised AML/CFT bill should be adopted as soon as possible.

We share staff's appraisal on structural reform priorities. Creating opportunities in the formal labor market and improving governance for a better business environment are crucial. On corruption issues important steps have been taken since 2015 and progress has been made towards rebuilding confidence in public institutions like the tax and customs administration, public procurement activities, and the Attorney general's office. We consider the staff's focus on this topic very helpful, esp. Box 2 with its concise and informative overview.

Mr. Psalidopoulos and Ms. Collura submitted the following statement:

We thank staff for their set of papers and Mr. Hurtado and Mrs. Del Cid-Bonilla for their buff statement. We share the staff appraisal and offer a few comments.

We take positive note that the staff report identifies raising living standards as the main challenge facing Guatemala, and broadly shapes the policy advice consistent with the goals of supporting growth and reducing the high level of poverty. Despite positive rates of economic growth, a sound fiscal position, low and stable inflation—among the key factors of stability—an appropriate increase of income per capita has remained elusive. A subdued outlook and risks tilted to the downside also do not point to improvements; moreover, the diminishing prospects for reforms in the near future (which seem to be assessed by staff as a fact and not as a risk) are in our view sources of major concern.

The Guatemalan authorities should reassess the functions and role of the State in the economy. With very low revenue mobilization and expenditures, and feeble fiscal redistribution, there is sizeable and wide-ranging scope for a positive change, along the lines identified by staff (including the advised near-term expansionary fiscal policy). In the fall 2017 Fiscal Monitor, staff made the case for a well-designed Universal Basic Income; we wonder whether the team has explored the desirability and feasibility of such an instrument in Guatemala. The staff's comments are welcome. In addition to the need of increasing public spending on health, education and infrastructure, adequate emphasis should be put on encouraging private investment (currently, consumption is the most important driver of growth, Figure 1), beginning with an improvement of the business climate and the swift implementation of ILO Convention 169. We take positive note of the resilience of the financial system and we are reassured by staff assessment of the manageable impact of stress events; we encourage the adoption of prudential measures to mitigate exchange rate-related risks.

The external position is assessed to be stronger than the level consistent with medium- term fundamentals and desirable policies. We note that the political and institutional risk indicator for Guatemala has been adjusted as it was considered not consistent with the country circumstances. Could staff provide more details on this adjustment? How has the appropriate level for this indicator been determined? Information on other country cases where this adjustment has occurred would be helpful.

In the last years, Guatemala has made important progress in fighting corruption and organized crime; we encourage the authorities to continue improving governance, including through the enhancement of the AML/CFT framework. The selected issues paper summarizes progress and identifies measures – which all seem valuable – to achieve more transparency in several areas; the paper estimates also possible gains from lower corruption by using several third-party indicators (TPIs). We note that the reader is not informed of the TPIs' limitations and the need to interpret them with caution, and that the reference to World Bank Governance Indicators is not accurate. In line with the recent review of the Fund's governance policy, the analysis would have been enriched by a detailed stocktaking of the vulnerabilities of the state functions and an overall assessment of corruption. On the estimation of the impact of corruption on economic growth, we wonder whether the use of a selected sample of countries (maybe the region as it is the case in the recent SIP for Angola's Article IV, or countries with comparable characteristics) would have produced a more focused outcome.

Mr. Fachada and Mr. Coronel submitted the following statement:

We thank staff for the reports and Mr. Hurtado and Mrs. Del Cid-Bonilla for their insightful statement. We commend staff for the analytical quality and relevance of this year's Article IV report and selected issues paper (SIP). The themes discussed in both documents present distinctive features of the Guatemalan economy, and help contextualize the country's challenges in promoting inclusive growth, mobilizing tax revenue, and enhancing governance, among others.

Guatemala has a track-record of macroeconomic stability and strong fundamentals. As highlighted by Mr. Hurtado and Mrs. Del Cid-Bonilla in their statement, the Guatemalan economy remains remarkably resilient to shocks as a result of the authorities' well-established sound macroeconomic policies. GDP growth (around 3½ percent on average in the 2010-2017 period) has been relatively robust and stable for Latin America standards. A positive external environment, combined with the strong macroeconomic framework and some fiscal space, are expected to support economic growth going forward.

The Guatemalan authorities have maintained a prudent fiscal stance through the years. As a consequence, the public debt-to-GDP ratio is among the lowest in Latin America. We take note of the rejection of the government's 2018 budget, which embedded some fiscal expansion, and encourage the authorities to reach an agreement with Congress as soon as possible. More generally, increasing government spending in infrastructure and social policies depends ultimately on reversing Guatemala's endemic low revenue-to-GDP ratio. According to the 2016 IMF's Fiscal Transparency Evaluation, the elasticity of tax revenue collection to nominal GDP declined from 1.2 percent in the 1998-2007 period to 0.6 percent in 2008-2015. Can staff comment if these estimations have been reviewed? Also, how this low elasticity compares to other Central America countries?

Inflation has remained within the Banco de Guatemala (Banguat) target range, firmly anchored by prudent monetary policy. Food price volatility, higher commodity prices, and supply disruptions can cause temporary inflationary spikes, but permanent price pressures seem relatively well contained. We take note that the authorities see limited space for further monetary easing, given the closing output gap and the ongoing U.S. monetary policy normalization. We also take note that the authorities do not agree with staff's reclassification of the exchange rate regime from floating to stabilized. Though we tend to concur with the need for more FX flexibility, the authorities should manage the timing and pace of the process.

Although achieved through prudent policies, Guatemala's solid growth has not benefited all in society. As mentioned above, increasing social spending hinges on enhancing revenue mobilization. We suggest that the authorities take advantage of the country's consistent economic growth performance and strong fundamentals to address more forcefully poverty and inequality, particularly in the rural and indigenous areas.

Some of Guatemala's main challenges include improving the levels of citizen security and the business climate, and combating corruption. Besides the direct economic costs, crime, violence and corruption continue to constrain private investment and inclusive growth. The passing of a new procurement law and the ongoing efforts to tackle organized crime and corruption, with the UN's assistance, have gained public support and are expected to render positive effects. However, in the short-term, certain high-level cases seem to have triggered collateral effects, freezing the government's decision-making process. We emphasize the need to build-up Guatemala's own law enforcement and judicial capacity, while putting in place a long-term strategy against the underlying causes of crime, violence, and corruption.

Mr. Alogeel and Mr. Rawah submitted the following statement:

We thank staff for a well-focused report and Mr. Hurtado and Mrs. Del Cid-Bonilla for their helpful buff statement. We are in broad agreement with the staff's analysis and policy recommendations and would limit our remarks to a few issues.

We take positive note of the preservation of macroeconomic stability despite domestic challenges. Indeed, inflation expectations have been firmly anchored and fiscal deficit has remained at decade lows. Also, the external position has been strong, backed by the upsurge in remittance inflows and the terms of trade gains. At the same time, Guatemala's near-term prospects are subdued mainly on the back of the limited government spending and the expected delay in implementing key economic reforms until after the next year's election. Here, we share staff's view on implementing concerted policies with a view to safeguarding the economy against the near-term downside risks and pursuing higher economic growth over the medium-term.

It is regrettable to note that poverty remains elevated because the growth performance falls short of the needed level. Decisive actions are therefore warranted to improve the living standards of the Guatemalans. To this end, we agree with staff on pursuing policy measures on multiple fronts. Specifically, channeling fiscal support toward high-impact projects underpinned by further efforts toward enhancing revenue mobilization and rising the efficiency of government spending is crucial. In this context, we call on the authorities to continue their efforts toward improving the budget execution to expedite project implementation. Also, we emphasize the importance of improving the execution of social spending, including through finalizing the household census update and enhancing the monitoring of beneficiaries' eligibility.

It is encouraging to note that the financial system is sound and well-regulated and that banks are well-capitalized with low nonperforming loans. We also agree with staff that the macroprudential framework could be further strengthened, including through the gradual shift towards Basel III standards. Moreover, the financial sector resilience could significantly benefit from reinforcing the bank resolution framework and finalizing the draft AML/CFT law, as rightly emphasized by staff.

Finally, we share staff's view on the importance of supplementing the reform agenda with measures to improve the business environment, and create job opportunities for the nationals in the formal sector. We also encourage the authorities to step up their efforts to address the infrastructure deficiencies, which increase logistics costs to enterprises and act as a major impediment to growth.

With these remarks, we wish the authorities further success.

Mr. Inderbinen and Mr. Djokovic submitted the following statement:

We commend the Guatemalan authorities for their prudent macroeconomic policies. Sound fiscal and monetary policy remain essential in shielding the country from shocks and preserving stability. At the same time, political uncertainty is slowing reforms, undermining confidence, and weighing on growth. The key policy challenge is to raise potential growth and improve the living standards of the broad population. We note the high levels of poverty, and also the incidence of extreme poverty, which underlines the need for further progress in reaching the Sustainable Development Goals.

We welcome the authorities' focus on improving the transparency of public finances and increasing revenue. Over time, these efforts will allow for increased outlays on social programs and infrastructure. We agree that the weaknesses in tax collection, and in particular the structurally low revenues, call for a broad tax policy overhaul. We note that Guatemala currently lacks key elements of a modern tax system, and that revenue needs to be increased by approximately 3½ percent of GDP to enable the state to fulfill basic public policy functions. We note that the tax reform recommended in the 2016 Article IV was rejected by Congress, and that currently there is little political appetite for a broad-based revenue reform. The delays may be regrettable, but they underline the political economy constraints within which the authorities conduct fiscal policy.

The persistently low levels of both private and public investment need to be addressed. Shortages of core public infrastructure have hindered higher economic growth. Also, we note from the SIP that confidence and uncertainty play an important role in determining private sector investment activity. In that context, the authorities' efforts to enhance the business climate, including their intention to reduce red tape and amend the Competition Law, are encouraging. Also, the ongoing efforts to improve governance and fight corruption will be critical to durably raise private investment.

We commend the authorities for their prudent monetary policy. We share the authorities' view that at this juncture there is a limited space for additional monetary accommodation, for the reasons stated in Mr. Hurtado and Mrs. Del Cid-Bonilla's informative buff statement. We encourage the authorities to continue addressing the high dollarization in order to reduce financial sector risks and improve the transmission of monetary policy. Can staff provide information on the strategic orientation of de-dollarization efforts? We are encouraged by the legislation in train to further strengthen the AML/CFT framework. This will be critical to combat crime and corruption, and to minimize any risks of the withdrawal of correspondent banks.

Finally, we encourage the authorities to consent to publishing the staff report.

Mr. Just and Mr. Varga submitted the following statement:

We thank staff for the informative reports and Mr. Hurtado and Mrs. Del Cid-Bonilla for their helpful buff statement. Guatemala’s economic performance is stable, fiscal and monetary policies are sound, public debt is low and the current account is in surplus. However, the weak institutional framework, widespread corruption and fiscal constraints hinders the elimination of widespread poverty and an increase in welfare. The authorities will need to implement sound investments in human and physical capital to help achieve the Sustainable Development Goals and improve the business environment to enable higher private sector led growth.

More social spending will require tax reform, higher tax revenues and more spending efficiency. Higher social spending, investment in human capital and more infrastructure spending is required to reduce inequality as well as close the significant gap in social and economic conditions between Guatemala and other countries in the region. A fiscally conservative approach has underpinned macroeconomic stability, which constrains significant increases in public expenditure to make sustained progress on the social agenda. The authorities should therefore strengthen tax and customs administration as well as increases tax compliance in order to generate additional revenues; in addition, public procurement and budget execution should be improved to ensure spending efficiency.

The Guatemalan authorities’ monetary policy was successful in keeping inflation within the central bank’s target band in the last five years. We agree with staff that the inflation targeting regime would benefit from a more flexible exchange rate. This would contribute to de-dollarization of the economy. While we would welcome more detail underpinning the reclassification of the exchange rate, we commend the authorities for already widening the margin of their FX interventions.

Structural reforms, especially in governance, are needed to lift potential growth and reduce poverty. Guatemala needs to step up its efforts to fight corruption and improve governance both by strengthening anti-corruption agencies and limiting illicit financing opportunities by an enhanced AML/CFT framework. The staff rightly acknowledges the authorities’ anti-corruption efforts in the selected issues papers. The staff’s diagnoses on governance are pertinent and the advice appears well-tailored to the needs of the authorities. We strongly recommend the authorities to follow up on them. However, we encourage staff to adhere to the Framework on Fund Engagement on Governance Issues, and avoid presenting country rankings based on third-party indicators.

Ms. Barron and Mr. Kikiolo submitted the following statement:

We thank the staff for the report and for the relevant and high quality selected issues papers and Mr. Hurtado and Mrs. Del Cid-Bonilla for the buff statement. Guatemala has a sound macroeconomic framework that, as Mr. Hurtado and Mrs. Del Cid-Bonilla note, has resulted in a solid track record of macroeconomic stability. But 60 percent of the population are in poverty and 23 percent in extreme poverty. While macroeconomic stability is necessary, it is not sufficient to move people out of poverty. Important structural reforms will need to continue to the greatest extent that the political situation allows in order to support medium term growth and allow the country to address its development gaps. We concur with the thrust of the report and staff recommendations and limit our comments to the following areas for emphasis.

The monetary and exchange rate policies remain appropriate. We commend the authorities for anchoring inflation expectations and achieving its inflation target. We agree with staff that the authorities consider using further accommodative monetary policy measures to support growth and are encouraged that the authorities will consider further cuts in policy rates if downside risks materialize. Authorities are also encouraged to adopt staff recommendations to modernize the financial sector. The efforts by the authorities to strengthen the AML/CFT framework and improve financial inclusion are commendable.

We agree that the authorities need to raise spending as well as improve expenditure efficiency. We support the authorities’ intention to introduce a supplementary budget that will aim to raise spending by up to ½ percent of GDP in 2018. We understand the authorities focus on increasing expenditure in visible and high impact spending programs. Could staff elaborate on which specific programs the authorities have in mind? We recognize the current political difficulties in passing tax reforms in Guatemala means that wide-ranging tax reform may not be feasible in the short term. Instead we urge the authorities to immediately strengthen revenue and customs collections through administrative measures which can raise revenue by an estimated 1 percent of GDP.

Increased private investment is necessary to achieve the rates of growth needed to deliver inclusive growth. The selected issues papers on investment and improving governance clearly states that addressing corruption is key to improving business confidence and investment certainty. We commend the wide range of policies that Guatemala has introduced to address corruption and improve governance, including measures to promote transparency in government processes and weed out corruption from public offices, and support staff's recommendations for further actions.

Finally, we commend the authorities for mainstreaming the Sustainable Development Goals into the K'atun 2032 national development plan. We encourage the authorities to maintain close collaboration with the Fund, the World Bank and other international agencies to resolve the financing issues around the national development plan.

Ms. Villa and Mr. Ismail submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Hurtado and Mrs. Del Cid-Bonilla for their informative buff statement. Despite the relatively steady economic growth rates and macroeconomic stability, Guatemala's development outcomes lag other countries that are at a similar level of development. In comparison to regional peers, poverty, malnutrition, and maternal-child mortality rates are high, especially in rural and indigenous areas. Against this background, a range of policies are needed to foster medium-term growth that will be sufficiently meaningful to raise living standards and to capitalize on the demographic dividend that is expected over the next two decades. We broadly concur with staff's assessment and would like to make the following remarks for emphasis.

A potent mix of policies is imperative to faithfully deliver the Sustainable Development Goals. We concur with staff that apt macroeconomic policies should be calibrated to foster higher and inclusive economic growth over the medium term. While we support staff's recommendation for fiscal support to boost near-term growth, we are inclined to agree with the authorities that there may be limited space for further monetary accommodation in view of upside risks to inflation. Could staff provide an update on the pending supplementary budget? We also agree that higher public investment in health, education and infrastructure are warranted to achieve higher social outcomes. We encourage the authorities to persevere with their anti-corruption agenda and improving the business climate, which are vital to spur investment and private sector job creation.

We urge the authorities to tackle the high labor market informality and widen the coverage of social security. Remittances are a structural feature of the Guatemalan economy from which over 6 million Guatemalans benefit. Despite the growing remittances, we welcome the findings in the SIP that there is no evidence of remittance-induced work disincentives. In this regard, labor market policies that bring the minimum wage in line with regional averages, together with extending the coverage for basic social protection are encouraged.

Progressive fiscal policy will be key to attain social and economic outcomes. We note the spending needs are assessed to be sizeable and Guatemala's tax revenues are one of the lowest in the world. These factors have continued to constrain the size of the government and its capacity to provide essential public goods. In this context, revenue mobilization through the strengthening of tax and customs administration, and a comprehensive tax reform should be pursued. Equally important, we agree that the efficiency of budget execution and protracted procurement processes should be improved without diluting the efforts on governance. Moreover, shifting the input mix towards greater capital outlays will help reverse the downward trend in public investment whilst improving the redistributive outcome on inequality and poverty.

The authorities' monetary framework has contributed positively to price stability and would be further enhanced through greater exchange rate flexibility. Particularly, it will ensure the primacy of the inflation objective and reinforce the Bank of Guatemala's (BOG) credibility. In this regard, limiting the triggers for FX intervention within the intervention rule is encouraged. In addition, continued efforts to discourage dollarization and foster the development of domestic capital markets will be essential to enhance the effectiveness of monetary policy. We also note that the BOG needs to be recapitalized. We request staff to clarify the authorities' intention for recapitalization and any prospective impact on the budget. We are pleased to note that the financial sector is sound with strong prudential standards. At the same time, the authorities need to continue their efforts towards strengthening the supervisory framework, including the AML/CFT framework, as well as enhance the financial safety net to bolster resilience and safeguard financial stability. The staff's comments on any concerns related to Correspondent Banking Relationships (CBRs) in Guatemala and their potential impact on remittances are welcome. In addition, we positively note the authorities' efforts on financial inclusion.

With these comments, we wish the authorities every success in their future endeavors.

Mr. Lopetegui and Mr. Lischinsky submitted the following statement:

We thank staff for the set of papers and Mr. Hurtado and Mrs. Del Cid-Bonilla for their illustrative buff statement. We concur with them on Guatemala's solid record of macroeconomic stability and strong resilience, as shown by the continued rates of economic growth, the stability of both interest and exchange rates, low inflation, low fiscal deficits, and one of the lowest levels of public debt in the region. We regret that these strengths were not mentioned at the beginning of the report in an introduction and we firmly believe that they should be mentioned up-front in the summing up.

Growth has been slowing down, to a rate of 3.1 percent in 2016 and it is estimated to be 2.8 percent in 2017, well below projections made for the Article IV consultations in 2016. Projections are now for a subdued recovery and growth is estimated to pick up towards 2020 at 3.8 percent. The slowdown was also felt in private consumption, investments, credit growth, and employment. These growth rates are insufficient to deal with the main challenges facing Guatemala; raising living standards to reduce poverty, job creation, increasing per-capita income, and reducing income inequality.

Hence, based on the stable macroeconomic and financial frameworks that buttressed the economy's strong resilience, and the need to increase inclusive growth, we concur with staff's advice to support domestic demand through a macroeconomic policy mix and the implementation of policies to reduce poverty.

Fiscal policy should be the main ingredient in the policy mix to support growth. Increasing spending limits would increase growth and, at the same time, the execution of the budget must be accelerated and improved, including anticorruption audits and procedures. To sustain a higher provision of public goods in health, education, and infrastructure, continued efforts are also needed to strengthen revenue mobilization. Measures are necessary to increase tax collection reducing avoidance and elusion by enhancing tax and custom administration. More fundamentally, introducing a tax reform that increase PIT rates and indirect taxes, simplifies the corporate income tax, and reduces tax exemptions. Tax revenue in Guatemala is below its peers in

CAPDR and countries with similar levels of development. We notice that the authorities are aware of the need for these efforts.

As staff indicates, sound monetary policy management has kept inflation low and expectations firmly anchored. While we would concur that there is space for the central bank to cut interest rates further if growth is lower than expected, we note that policy rates are already negative and below neutral levels, calling for caution. We would appreciate staff comments on the slow pace of private credit expansion in recent times, given that there appears to be ample liquidity in the banking sector. We support the advice to strengthen the balance sheet of the central bank and to work towards improving monetary policy transmission, including further development of financial markets. We are less certain on the need to relax more the central bank FX intervention rule, which has served the central bank well so far. The FX market is thin and there is value in preventing excessive volatility, and dollarization can be reduced more effectively through financial regulation rather than by nominal appreciation of the Quetzal. In addition, there seems to be agreement that part of the current account surplus is temporary and that the excess supply of dollars may reverse. And finally, nominal appreciation may bring inflation further below the low end of the inflation target. We take note of the authorities' position with regards to the reclassification of de-facto exchange regime. We understand that the reclassification is the result of the exchange rate remaining within a margin of less than 2 percent over six-month period and that the reclassification carries no judgment on the commitment of the authorities to the flexible exchange rate regime. The staff's comments are welcome.

We support the Fund's engagement with Guatemala and other institutions, including the World Bank and UN agencies, on the spending and financing implications of achieving the Sustainable Development Goals (SDGs). The country's poverty rate reaches almost 60 percent and extreme poverty 23 percent of the population and, in health and education, indicators are well below the average in Latin American and Central American countries. Specifically, measures should be implemented to seriously improve welfare of the indigenous population in rural areas, whose living conditions are noticeably worse. In this regard, we back the high-impact programs needed to achieve the SDGs mentioned in paragraph 16 of the report. Furthermore, we support staff in that the authorities should incorporate the ILO Convention 169 into the domestic legal system. Is there data on income distribution and of public expenditure received by the indigenous population? The staff's response is welcome.

The banking system is solvent, liquid, well-regulated, and strong in the fight against money laundering. We commend the authorities' efforts to improve financial inclusion, as only 17.5 percent of the adult population is in the credit registry coverage. To modernize the sector and build resilience we support the measures in paragraph 25 of the report.

We commend the Guatemalan authorities for their continued efforts and progress in fighting corruption and call on them to publish the Article IV report and related papers.

With these comments, we wish the authorities and people of Guatemala all the best in their future endeavors.

Mr. Palei and Mr. Tolstikov submitted the following statement:

We thank staff for a comprehensive set of papers and Mr. Hurtado and Mrs. Del Cid-Bonilla for their helpful buff statement. Guatemala's track record in maintaining macroeconomic stability is strong. Key macroeconomic indicators, including inflation, interest rates, fiscal deficits, and public debt level have remained among the lowest in the region for many years. The exchange rate is stable and the banking system is solvent and liquid. However, macro stability still needs to be translated into higher growth and improving living standards for the majority of the population. To address the high poverty rate and to achieve the Sustainable Development Goals, Guatemala needs to boost growth and increase spending on education, health, and infrastructure.

The achievement of higher medium-term growth depends on the efforts to increase investment, public and private, from their persistently low levels. The authorities need to boost public investment through targeted and high-impact SDG-oriented programs, and additional fiscal revenue should be mobilized in order to provide necessary financing. Given Guatemala's low level of tax effort, strengthening revenue administration is an obvious policy priority. In consultation with the IMF and their development partners, the authorities should consider raising some taxes, including PIT and indirect taxes, and reduce the scope of tax exemptions.

On the expenditure side, the spending efficiency would benefit from greater flexibility of budget procedures as well as from improved transparency and efficiency of personnel expenditures. We also note that public investment and procurement activity was recently stymied by the reluctance of public officials to approve projects and public bidding out of fear of anti-corruption persecution. Ensuring legal certainty for public officials is critical for normalizing the public investment process.

According to the staff report and the special chapter in the selected issues paper, Guatemala's efforts to fight corruption are remarkable, and its experience may be instructive for other members of the Fund. We note that Guatemala was the first country that about ten years ago adopted the use of a new type of anti-corruption institution fully independent from the local authorities – the International Commission Against Impunity in Guatemala (CICIG). Later on, the CICIG-like anti-corruption body was also created in Honduras and, if we understand correctly, it is now considered by staff as a model for other Fund members with high-level corruption. The IMF now provides technical assistance in this area. In this regard, we would appreciate more detailed information on the functioning of the CICIG, including its mandate, sources of financing, and procedures of appointing its management and staff. Could staff elaborate on the role and place of the CICIG among other law-enforcement institutions in Guatemala?

We welcome the chapter in the SIP on the influence of better governance on growth. It provides a lot of information on the various aspects of Guatemala's efforts in improving its governance, of which the anti-corruption campaign is an important part. As Figure 2 on page 44, shows, corruption in Guatemala remains the second most problematic factor for doing business, and its relative weight has not changed over the past ten years. At the same time, "Inefficient Government Bureaucracy" has become the third most important impediment, which corresponds with concerns about stalled public investment.

On a related matter, we note that in many recent reports staff justify macroeconomic importance of the fight against corruption pointing to association between the third-party indicators of corruption, on the one hand, and GDP per capita growth, on the other hand. Could staff provide the information about the dynamics of the third-party indicators on corruption in Guatemala since 2007 (the year when the CICIG commenced its operations)? We would be interested to learn about changes in the Control of Corruption Index from the WGI and the Corruption Perceptions Index from Transparency International. What is, in the staff opinion, the impact of changes in these indicators on investment and economic growth in Guatemala?

Mr. Claver-Carone and Ms. Svenstrup submitted the following statement:

Guatemala has maintained macroeconomic stability thanks to sound economic management, despite recent political events. Nevertheless, forceful action is needed to boost near-term growth, and we strongly urge the authorities to prioritize pro-growth measures over the remainder of this Presidential term. With nearly 60 percent of the population living in poverty and high inequality, progress cannot wait until after the 2019 elections.

We agree with staff that Guatemala must increase public investment and high-quality social spending, which should focus on high-impact projects rather than increases to current spending. Boosting public investment cannot happen without improvements in execution, and we urge the authorities to press forward with reforms to improve procurement and contracting. Comprehensive tax reform, as outlined by staff, will be needed in the medium term to sustainably fund development. What revenue areas should authorities prioritize for the remainder of this term?

To boost private investment Guatemala also must to take further steps to improve the business climate, notably to provide regulatory certainty to foreign investors by incorporating ILO Convention 169 into national legislation. The 22 percent contraction in mining activity amid court-ordered suspensions of mining activities is particularly noteworthy. There is also potential for greater regional energy integration, including electricity, to create efficiencies and improve the business environment.

We agree with staff that Guatemala's external position is stronger than the level consistent with fundamentals and desired policies. However, we think that the discussion of adjustments made to the CA norm could have been clearer. First, we note that staff adjusted the ICRG "Law and Order" variable. Could staff provide the specific adjustment (e.g., we see that Guatemala scored 2.5/6 at end 2017 versus Colombia and Argentina's score of 2/6 – how was this modified)? Why did staff adjust this ICRG variable versus "Investment Profile" or "Corruption," and how does this compare to the political adjustment made in the recent Thailand Article IV discussion? Second, we understand that remittances are included in the EBA-lite CA model. Could staff discuss why they only used EBA CA and EBA-lite ES, and provide the results for EBA-lite CA? Further, in paragraph 5 of the ESA, saying that the EBA CA norm will "improve" to indicate an increase is a values-based statement that should be avoided.

We welcome the authorities' ambitious anti-corruption strategy, but note that sustained and highly-visible effort will be needed going forward to prove the credibility of these initiatives. We welcome staff's excellent work on governance and corruption in this report, which we see as consistent with the Board-approved Framework for Enhanced Engagement on Governance. In particular, we found the selected issues paper’s analysis of the impact of corruption on real GDP helpful.

We also strongly agree with staff’s assessment about the need to adopt and implement the revised AML/CFT bill, including enhancing supervisory oversight over beneficial ownership.

Finally, we urge the authorities to consent to the timely publication of the staff report and associated documents.

Mr. de Villeroché and Mr. Rebillard submitted the following statement:

We thank staff for a comprehensive set of reports, as well as Mr. Hurtado and Mrs. Del Cid-Bonilla for their insightful buff statement. After a slowdown in 2017, growth is expected to pick up towards its potential this year and next. Despite enhanced macroeconomic stability, potential growth remains moderate; progress towards achieving the Sustainable Development Goals (SDGs) and raising living standards of Guatemalans will require additional policy efforts on a number of fronts, especially Domestic Revenue Mobilization (DRM). We commend staff’s analytical work on the potential fiscal reform components and their likely impact on inequality, as well as on the growth impact of improving governance. We largely agree with the staff’s appraisal and recommendations, and would like to add the following comments:

Policy Mix

Macroeconomic stability, underpinned by low public debt, moderate (and likely temporary) external imbalances, and headline inflation comfortably within the target range, is a key strength of the Guatemalan economy. However, investment remains constrained and has weighted on growth lately. We concur with staff that, given Guatemala’s substantial fiscal space, a macroeconomic policy-mix geared toward supporting demand would be appropriate. Ensuring greater exchange rate flexibility would also be helpful to absorb external shocks are encourage de-dollarization of the economy.

Domestic Revenue Mobilization

Achieving significant progress towards SDGs and raising living standards will require strong measures to boost potential growth. Efforts are needed to improve infrastructure, education and health. In particular, the investment-to-GDP ratio is very low, at 12.1 percent in 2017, including when compared to peers (text figure page 5). While development needs are large, like staff we see significant scope for additional DRM efforts given the low public-revenue-to-GDP ratio; from the current level of around 11 percent, achieving staff's target of 15 percent will require strengthening tax and customs administration but also, more broadly, a comprehensive tax reform. While all levers should be considered, we would see strong merit in raising personal and corporate income tax rates, in light of their current low level (as detailed in tables 1 and 2, page 61 of the selected issues paper). Such measures would also boost the tax system's progressivity and help address high inequality, together with appropriate spending of the additional revenues generated. Tackling widespread informality would also be instrumental in raising public revenues, as well as promoting a fairer tax and social protection system.

Structural Reforms

Measures to foster private investment, including by improving the business climate, will also be critical to boost potential growth. In this regard, we strongly encourage the authorities to adopt the pending Competition Law as soon as possible. We commend the authorities for their ongoing efforts in the fight against corruption, as detailed in Box 3 of the report. Indeed, the dedicated section in the selected issues paper tends to show that intensifying such efforts to improve governance could lead to substantial gains in terms of per capita GDP. Strengthening the AML/CFT framework would also be crucial to fight corruption and organized crime; the authorities' efforts to finalize the draft AML/CFT law are is this regard highly welcome.

Ms. Horsman, Ms. McKiernan and Mr. Feerick submitted the following statement:

We thank staff for the report and their interesting selected issues papers. We also thank Mr. Hurtado and Ms. Del Cid-Bonilla for their well written and useful buff statement. Over many years, Guatemala's macro-economic framework has proved resilient to shocks and provided a degree of stability to the population. At the same time, social outcomes remain amongst the lowest in the region. As such, it is clear that a step change is needed to deliver on the authorities' stated commitment of progress towards the Sustainable Development Goals (SDGs). We broadly support staff's appraisal and offer the following remarks for emphasis.

Considering the negative, albeit small, output gap and the necessity to increase expenditure on social and capital projects, we support staff's recommendation around an accommodative policy stance. On specifics, we agree with staff's recommendation on mobilizing revenue to facilitate increased investment and improved social outcomes; these are necessary to enable progress towards meeting the SDGs and supporting supply-side expansion over time. However, the sequencing should be considered closely. Would staff comment on their prioritization in this regard? On tax, the weaknesses in the tax base and in tax collection merit a strong response; with some 70 percent of workers in the informal sector, at present the tax burden is borne by a relatively small cohort of the working population. In advance of any significant increase in PIT rates, a redoubling of efforts to bring informal workers into the tax net is necessary to prevent a further undermining of taxpayer willingness to pay. We welcome the useful options for consideration in this regard in paragraph 18. On the issue of trust between taxpayer and institutions, there is also the need to demonstrate value-for-money and efficiency on the expenditure side of the equation. The staff also offer valuable recommendations in this space.

We welcome the fact that the banking sector is assessed as robust across a suite of stress tests. In terms of risks, staff consider that a small but serious tail risk is the potential restriction of fund transfers from the United States. To help mitigate the probability of this occurrence, the AML-CFT framework should be improved as a matter of urgency and we note that draft legislation is being finalized.

Finally, on the inflation targeting framework, we welcome the authorities' intentions to reduce their FX interventions and restate the primacy of the inflation objective.

Ms. Del Cid-Bonilla informed the Board that the authorities had consented to the publication of the report.

Mr. Sishi made the following statement:

We thank the staff for the comprehensive report and Mr. Hurtado and Ms. Del Cid-Bonilla for their informative buff statement.

We did not issue a gray statement, but we do wish to make a few remarks for the record.

While we take note of the stronger external sector and the strong record of macroeconomic stability in Guatemala, we join other Directors in noting that growth is still weighed down by weak aggregate demand and restrained private sector sentiment. In this regard, we broadly agree with the staff's analysis and policy advice, and we welcome the authorities' latest efforts to adopt policies that reduce poverty, strengthen the financial sector, and support stronger growth.

The staff report highlights the limited progress in social spending and investment infrastructure, while projections in Table 2 do not indicate improvements in government revenues over the coming years. In addition, reasonable growth rates over a sustained period have had a limited impact on poverty and unemployment. This situation is not unique to Guatemala. These structural issues have been raised in numerous countries for several years, with the Fund giving comprehensive advice to countries. In this regard, we would urge the Fund, in collaboration with the World Bank, to undertake a broad stocktaking of the success or otherwise of structural reform implementation across a wide range of developing countries, and this should be discussed by the Board. Such an assessment should give better insight into the effectiveness of the Fund's advice in relation to institutional development, domestic revenue mobilization, and labor market reforms, among other things.

Finally, we welcome the authorities' anti-corruption strategy, and we encourage them to maintain its momentum. We also support the staff's call for a stronger Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework to support the fight against corruption and organized crime.

Mr. Claver-Carone made the following statement:

First, we thank the staff for the report, and we clearly acknowledge the challenges that Guatemala faces. Those are all detailed in the report—the reforms that need to be made, the political challenges, et cetera. However, I also want to make sure we emphasize the positives. I note that in the mission concluding statement, it said, "underpinned by solid, hard-earned macroeconomic stability, Guatemala's near-term growth has been good." That is despite those challenges. That assessment was not particularly included in the staff report. It was a little more tempered, for whatever reason. But we do want to acknowledge they are moving in the right direction and the challenge they face of being able to continue and to enhance those growth policies while facing those challenges. That is a balance that needs to be struck.

I would also take the opportunity to urge the Guatemalan authorities on the issue of energy, which is not included in the report, to be able to work toward finding efficiencies for energy or prices and things that can be of benefit to itself and its neighbors, including Honduras, Belize, and others. That is a regional issue that they can work more on for the benefit of not only Guatemala but for the region.

Finally, I have an external sector assessment question for the staff. We thank the staff for the responses about the External Balance Assessment (EBA) model. But could the Strategy, Policy, and Review Department (SPR) clarify how the expanded International Country Risk Guide (ICRG) index and the updated EBA model would impact Guatemala? Would the staff still need to adjust this variable under the new model?

Mr. Leipold made the following statement:

I thank the staff for their work and for the answers to the technical questions.

I would like to focus on answer 17 on the external sector assessment, where we still harbor some doubts, in particular, on the adjustment that is made to the indicator of the country's institutional political risk, which is drawn from the ICRG survey. We are specifically requesting the appropriateness of modifying the value of the index, itself. This is not because we are particularly enamored by third-party indicators (TPIs). The Board knows that we have reservations, and we have been prudent about the quality of the information that can be drawn from TPIs. That being said, modifying the index simply because it does not seem to correctly capture some known information strikes us as arbitrary. If the level of investment or other variables do not seem to be consistent with what could be expected compared to other peers, from a country's institutional political risk, it would be more robust to adjust the coefficient of the index, as was done in the case of Thailand.

Incidentally, the way the report on Thailand was written, without any mention of this adjustment of the coefficient, led the reader to assume that the staff's adjustment was directly on the value of the norm—that is, on the output of the regression, which was still arbitrary but distinctly more acceptable than an outright, direct change of the value of the index itself.

Why are we using TPIs to begin with? Because the Fund is deemed not to have the internal expertise necessary to precisely capture the phenomenon at hand. In the case of the ICRG, the TPI digest says that it is compiled by using official data and expert judgment, which we are not deemed to have. If we do not have that expertise, then we do not have it to directly alter the value of an index.

All in all, I believe that using the same approach as in the case of Thailand appears preferable. This is not a Guatemala-specific point, but a general point about the EBA and the assessments. It also would have the additional benefit of not making any implicit ranking among countries. That was my main point.

Mr. Tolstikov made the following statement:

We asked a question in our gray statement related to Guatemala's anti-corruption efforts and about the changes in third-party corruption indicators. On this issue, the staff answer was unspecific. In fact, Guatemala's ranking in both the Corruption Perceptions Index and the Control of Corruption Index have deteriorated over time. According to Transparency International, Guatemala's ranking declined from the 84th place in 2009 to 147th place in 2016. The ranking in the Control of Corruption index has also deteriorated. If we take this at face value, we can even conclude that Guatemala's anti-corruption efforts were counterproductive. However, the staff rightly underscores that these are perception-based indicators and, therefore, we may have been presented a distorted picture. We would like to ask how the staff assesses the improvements in the control of corruption in Guatemala and the possible ways to design a more accurate way to assess it. What is the value of using such TPIs?

Second, corruption perceptions directly influence investors' confidence. Whatever we, in the Fund, think about success in reducing corruption, the investors make their decisions according to their perceptions. The lack of investment in Guatemala corresponds well with the deteriorating perception about corruption. Does the staff see any way to improve this adverse feedback?

Mr. Fachada made the following statement:

I commend the staff for the quality of the report and the selected issues paper. Like Mr. Claver-Carone, I believe that maybe the staff report does not highlight the fact that the Guatemalan economy through the years has had prudent macroeconomic management, is a resilient economy with great stability. Compared to the rest of Latin America, the indicators of public debt and fiscal deficits are low.

I have one question related to corruption, an issue that Mr. Tolstikov has just raised. In the selected issues paper, there is a discussion of corruption. Figure 1 presents a chart on anticorruption efforts in Latin America and the Caribbean. I would like to hear from SPR if this is consistent with the recently approved framework on the Fund's engagement in governance issues, and the guidance not to present rankings comparing governance vulnerabilities of IMF members.

The staff representative from the Western Hemisphere Department (Ms. Perez Ruiz), in response to questions and comments from Executive Directors, made the following statement:[1]

I thank Directors for the gray statements and for the pointed comments in this meeting. I would like to start by thanking the Guatemalan authorities for their collaboration and hospitality during the Article IV consultation.

In addition to the written responses we circulated earlier, allow me to address a few policy issues raised by Directors. In particular, I will articulate my intervention about the role of macroeconomic stability and macroeconomic endurance, the contribution of fiscal policy to growth this year and the role of the monetary policy stance, and the strategy on poverty alleviation. It is important for us going forward. It is becoming prominent with Guatemala and the anti-corruption agenda.

On macroeconomic stability, as Directors note, this is a well-established feature of the Guatemalan economy; and over the past year, it has been an important asset to shield the economy from volatile politics, as the authorities rightly pointed out in their buff statement. We recognize that in paragraph 2 of the staff report, where we say that, despite this political uncertainty, macroeconomic stability has remained intact. It is a good basis on which to move forward, but it is not that macroeconomic stability can solve entrenched poverty and lack of convergence with a middle-income group of countries.

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

Second, on the contribution of fiscal policy to growth, this year the latest data releases point to even more weakness in terms of economic activity, confidence, and inflation, which persisted through April. That makes it more likely that the downside risk in our outlook for this year of 3.2 percent will materialize.

To reverse these trends—and I am coming to the question on execution and where we stand with the budget—the authorities are making an important effort to elevate the fiscal impulse for this year by passing a supplementary budget that would raise the spending limits by up to half a percentage point of GDP. This is greatly appreciated so far. One-third of this amount has been approved by congress, and we strongly encourage the authorities to continue to persuade congress of Guatemala's present spending needs, with a particular focus on capital spending.

In parallel, we perceive that the authorities are strongly committed to enhancing their budget execution capacity. Efforts are underway to expedite the infrastructure projects that were coming over from the past years and also to favor—this is very important—administrative procedures over criminal procedures in procurement when it comes to the controller that is at the heart of the paralysis in public procurement in 2017.

The staff hopes that these measures and others that we have laid out in paragraph 10 of the staff report will soon bear fruit; but at the same time, growth risks are tilted to the downside. Therefore, if fiscal policy falls short and growth and inflation do not strengthen in the coming months, the staff advises the central bank to consider further cutting rates as a second-best option. The staff's case for further monetary accommodation is based on two premises.

First, Guatemala is likely to stay and operate below capacity for a while, and that is likely to lead core headline inflation to fall below the midpoint of the target.

Second, turning to the specific question posed by Directors on potential financial stability risks from further monetary accommodation, we believe that a narrowing differential with Fed policy rates is likely to generate marginal or minor financial stability risks. Further accommodation is likely to bring some portfolio reallocation—orderly, in our view—because of Guatemala's strong fundamentals, and also because foreign exchange quotation is predominantly driven by remittances. Remittances are about seven times as high as portfolio inflows for Guatemala. In addition, foreign exchange depreciation would be moderate because of what was mentioned. That is expected to lead to very moderate pass-through effects, given the available estimates on this matter. On financial stability, banks seem to be resilient to foreign exchange depreciation, as evidenced by stress tests. We do not see major financial stability risks from this move.

Turning to poverty alleviation and the strategy to combat poverty, this issue resonated in Directors' gray statements, and some others have alluded to it in this meeting. We had the distinct impression during the mission that the authorities fully recognize and fully embrace this challenge and have embedded the Sustainable Development Goals (SDGs) in their national development strategy, and mission discussions on this front were extremely productive and led to the identification of high-impact visible programs in pursuit of these SDGs. These include: expanding preventive and primary health care, increasing access to nutrition, water, and sanitation services, broadening the main conditional cash transfer program targeted to the very poor, expanding primary education, and maintaining and upgrading the roads network. These priorities have been now discussed in the context of the preparation of the 2019 budget.

Looking forward, Guatemala will be one of the pilots in the SDG spending initiative, which is spearheaded by management at the Fund. Our Article IV consultation was actually followed by an SDG mission. The purpose of the exercise is to cost the programs needed to close those critical development gaps and to help the authorities reconcile their long-term development ambition with a more practical, medium-term spending and financing strategy. We are engaging with them in the design of the prioritization and in the design of this financing strategy.

Garnering support for mobilizing additional resources is a challenging endeavor. And in this respect, both the mission and the authorities felt that, for political background, the legacy of the peace accords after the civil war and the fiscal compact in 2000, whereby Guatemalans tried to give themselves the means to create a better society from a social perspective - these all provide an excellent basis for dialogue on this matter and to garner support for tax reforms.

Lastly, several Directors asked questions pertaining to the governance agenda. I would like to express our gratitude to the authorities for their openness in discussing these complex issues and also for facilitating access to relevant counterparts: the general prosecutor, the International Commission against Impunity in Guatemala (CICIG).

The staff's recommendations related to corruption seek a balanced perspective. On the one hand, we appreciate the authorities' ongoing anti-corruption efforts, and those may not be visible or apparent from the corruption-based indicators which we have at our disposal. But if one looks more granularly at indicators on the prosecution of acts of corruption, we believe that the collaboration between the general prosecutor and the CICIG has resulted in increased prosecutorial capacities in the investigation of tax and corruption, and that led to the dismantling of up to 180 extensive criminal networks that had infiltrated Guatemala. They have been dismantled over the past three years. At the same time, we also encourage the authorities to persevere with their anti-corruption strategy, with a focus on raising conviction capacities, which still remain moderate. We believe that important initiatives in this respect include strengthening the judicial effectiveness and also reinforcing the asset disclosure regime for public officials.

I would like to address some of the issues raised in the Board by Directors. One referred to the scope for revenue increases. We believe that revenue mobilization needs action on multiple fronts. It needs tax reform, and that was also raised by some of the Directors in the questions: which tax reform, how comprehensive it can be, and if they have to proceed sequentially, how the authorities could start with tax reform. We addressed that question. But continued tax administration efforts is another pillar of the revenue mobilization strategy. The staff report devotes some space to that. Efforts should be focused on reinforcing VAT controls, strengthening the large taxpayer office, improving the use of already available tax information, enhancing tax collection faculties, including easier access to banks' secrecy provisions, and so on and so forth.

On the adjustment that we conducted in the context of the external assessment and the EBA methodology, when digging into the methodology, we felt that the ICRG indicator failed to capture some important dimensions that are holding back investment in Guatemala. The way the ICRG indicator is used now, it only has five of the components in it. Some dimensions that are missing are: bureaucratic quality, political stability, law and order. We feel that those factors are holding back investment for Guatemala. It is perfectly fine to have an ambitious norm, because a norm has in it a normative meaning versus a positive. But we felt that it would be difficult to see how Guatemala can get to that norm over a reasonable time horizon—certainly not the World Economic Outlook (WEO) time horizon. But even over a decade time horizon, the authorities have been working to fight crime, to fight corruption, to improve the democratic accountability of their institutions. But we felt that that norm was demanding and that it would be difficult within the current institutional setting to have that improvement in investment rates needed to deteriorate the current account by minus 3 percent within a reasonable time horizon. That is why we proceeded with this adjustment.

The way we did it is to look at other indicators that have broader dimensions for the political and institutional framework, and that is why we identified peers. When one corrects the ICRG in this way, then the norm becomes closer to what the mission intuitively could understand, that would be a benchmark for Guatemala over the not-too-distant future.

The staff representative from the Strategy, Policy, and Review Department (Ms. Murgasova), in response to questions and comments from Executive Directors, made the following statement:

I would like to answer a few questions. One is to follow up on the external sector assessment. There was a question: What would be the outcome of the new EBA model for Guatemala? The old EBA model included 5 of those 12 ICRG components, and the new EBA model includes all 12 of those. It is my understanding that the new model would result in a larger current account deficit norm for Guatemala than under the old model. At first sight, this appears different from what one would expect ex ante because it would imply that the country can run a larger current account deficit, using the broader ICRG coverage. This is true holding other things equal. However, the new EBA model includes other types of adjustments as well, so it is not clear that this one-to-one comparison can be made.

I would also like to address another question about the publication of rankings of TPIs. Indeed, following the Board discussion and the Board decision on April 6, the Managing Director issued guidance to the staff to refrain from using country rankings in perception-based TPIs in staff reports. This guidance was issued. In addition, the staff has updated the Indicators Digest, which was issued to the Board on May 16.

Mr. Leipold made the following statement:

I will return to my favorite subject: selected issues papers. This comment is not Guatemala-specific but has been inspired by this case. I readily concede, perhaps, that six selected issues papers for Guatemala are a bit many. But at the same time, I wonder: How would the Board be able to assess whether the policy or the approach that it has recommended on governance issues was actually being followed if, instead of a selected issues paper, we had a box. I would challenge anybody to translate that selected issues paper into a box. But let us say that was the case, how are we going to know in positive or negative whether the policy is being applied? We need to have a selected issues paper.

This is just to make a point. I look forward to seeing the note that was sent to the staff. I have requested it repeatedly, and I have yet to receive it. I hope to have it for the long weekend so I can enjoy it over Memorial Day, but I believe we deserve a response on that.

I would also once again ask that every time there is a footnote about the authorities' intention to publish, the mission chief please update the Board at the beginning of the Board meeting on the status of publication so that we can exercise peer pressure if needed.

Mr. Fachada asked the staff to elaborate on its approach to ranking countries in reference to perception-based TPIs in the case of Guatemala.

The staff representative from the Western Hemisphere Department (Ms. Perez Ruiz), in response to further questions and comments from Executive Directors, made the following additional statement:

On publication, this is an oversight on the side of the staff because I understand the authorities do not object to publication.

On selected issues papers versus boxes for corruption, we are featuring both because we thought that the issue should feature prominently during this consultation. The selected issues paper format gave us more space to discuss in detail a series of initiatives in the areas of public procurement, AML/CFT, and to provide more information on this unique experiment of having an international prosecutor in a country, the CICIG. We also did a quantitative analysis, a regression analysis. We provided context. When it comes to the issue of corruption and where Guatemala stands on anti-corruption efforts during this consultation, the selected issues paper was probably justified. But going forward, I also sense that there is some intent in the institution to streamline selected issues papers and to favor other products, such as working papers that are frontloaded relative to the time where the Article IV consultation takes place and that greatly facilitates the review process.

On the issue of the use of TPIs in the selected issues paper, our understanding was that Fund products should not use rankings of countries for perception-based indicators. In the introduction of the selected issues paper, we have a ranking, but that is not a ranking of the stock, but rather of the efforts performed by different countries over the last few years. There is a question as to whether that is consistent with the guide. What we can do is check this. In case of inconsistency or non-compliance, we are happy to drop those charts from the selected issues paper upon publication and just use language to explain that after the political scandal and the critical political crisis the country went through in 2015, the strengthening of anti-corruption efforts was greatly appreciated and well entrenched in the public's perception. We believe this is an important point that we should make. But this is a well-taken point, so let us check on that and adapt it accordingly.

Ms. Del Cid-Bonilla made the following concluding statement:

On behalf of the Guatemalan authorities, I thank Directors for their interest in Guatemala and for their valuable comments and recommendations, which I will fully transmit to them. I also thank the mission chief and her team for the candid and fruitful discussions during the Article IV consultation.

In the middle of significant institutional changes going on in Guatemala, also translated into some gridlock by congress that impacts the pace of the implementation of needed structural reforms, the authorities are confident that in the medium and long term, these changes will bear fruit, raising the possibility for a higher, sustainable, and more equitable growth that will benefit all of the Guatemalan population, particularly the most vulnerable and poor.

In the meantime, the authorities will continue making every effort to advance the implementation of the economic and social agenda, giving priority to improve the business climate; to accelerate spending execution, in particular in public infrastructure and priority social programs; and to continue strengthening the tax administration. They appreciate the support that the Fund, the World Bank, and other international agencies are giving to identifying and costing projects with high social impacts aimed at achieving or making progress toward achieving the SDGs. The authorities will also continue efforts to enhance governance, including the strengthening of the judicial system and the AML/CFT framework. The macroeconomic stability, the sound financial system, and the economy's resilience to shocks will continue being valuable assets to deal with the challenges ahead.

On monetary policy, the authorities appreciate the assessment made by the staff and their points of view. However, they still consider that further accommodation of monetary policy would not prompt higher credit growth because the problem is not on the supply but on the demand side.

On the external sector, the main factor explaining the stronger external position is the extraordinary and temporary inflow of remittances, the average rate of growth of which increased from 7 percent before 2015 to 13 percent in the last three years. The authorities are expecting that the current account will gradually normalize over the next few years. Meanwhile, there is an important trade deficit that remains large.

The Acting Chair (Mr. Furusawa) noted that Guatemala is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended Guatemala for maintaining a solid record of macroeconomic stability and resilience, supported by prudent economic management. This has allowed the country to withstand economic shocks and politically difficult circumstances. Guatemala's near-term growth has been good, although poverty levels remain high, and subdued confidence and diminished prospects for reform weigh on the outlook. Directors noted that a modest recovery can be expected with accommodative monetary conditions, recovery in budgetary spending from low levels and higher growth in the U.S. To guard against downside risks in the near-term and foster growth over the medium-term, Directors called for greater macroeconomic policy support for the economy. In addition, structural reforms are essential to sustain higher growth, help attract private investment, make growth more inclusive and reduce poverty.

Directors generally encouraged the authorities to adopt a supplementary budget that raises spending limits and supports near-term growth, with a particular focus on raising social and capital spending. A stronger effort is also needed to increase spending execution and flexibility. Directors emphasized that inadequate budgetary revenues constrain the government's ability to invest in physical and human capital. In this context, Directors called for an integral fiscal reform encompassing better tax administration and tax policy changes. They underlined that strong governance is critical to durably raise investment and support revenue mobilization.

Directors commended the authorities for keeping inflation expectations firmly anchored over the last several years. Directors considered that the central bank could remain open to lowering the policy rate if the contribution of fiscal policy to growth falls short of expectations, activity indicators have not strengthened by mid-year and inflation risks remain on the downside. Directors acknowledged the central bank's efforts to gradually widen the band before exchange rate intervention is triggered and called for continuing efforts to increase exchange rate flexibility to buffer against shocks. They also underlined the need for continued efforts to improve monetary transmission, including through a reduction in financial dollarization and development of domestic capital markets.

Directors welcomed the soundness of the financial sector. Nevertheless, there remains a need to further develop macroprudential policies and move toward Basel III standards, implement consolidated supervision, reinforce bank resolution, and strengthen the AML/CFT framework.

Directors called for continued efforts to raise living standards. Lifting investment and achieving the Sustainable Development Goals are important to capitalize on the demographic dividend that is expected over the next two decades. Directors encouraged efforts to expand social protection programs and combat informality to improve social outcomes.

Directors stressed the importance of improving the business climate, including through pro-competition reforms and by reducing the uncertainty weighing on extractive industries. Directors welcomed ongoing efforts to fight corruption, including measures to restore confidence in public procurement and to promote government transparency and accountability. Directors encouraged the authorities to strengthen judicial effectiveness and reinforce the asset disclosure regime for public officials.

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

APPROVAL: April 17, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Fiscal Policy

- ***Could staff provide more information on the status of 2018 budget and the dispute for mining company.***

Status of 2018 budget.

- The staff will respond to this question during the Board meeting.

Dispute for Mining Company

- For background, the mining industry has been a significant source of investment and government revenue for the Guatemalan economy. Over 2007−17, FDI in the mining sector was second only to FDI in the electricity sector and annual sales of metallic minerals grew from a negligible amount in the mid−2000s to consistently above Q5,000 million in 2014−16. Total royalties grew from very low levels in the mid-2000s to over Q187 million in 2015, while the court mandated suspension of operations at the Escobal mine impacted tax collection in 2017 by Q125 million.

- The license for operation of Escobal mine was granted in 2014. On court proceedings, on May 2017, ONG CALAS filed amparo against the mine alleging that the Ministry of Energy and Mines did not consult with Xinca population before granting the Escobal license. On July 2017, the Supreme Court (SC) temporarily suspended the mining license. On August 2017, the Constitutional Court (CC) affirmed SC's temporarily mining license suspension ruling and heard full case on its merits. On September 2017, the SC issued a definitive decision to reinstate Escobal's mining license. On October 2017, the CC held public hearing on the appeals of the SC's definitive decision. On October 31st, the Court's statutory deadline to decide the case expired. The case has been pending since.

- The closure of the mine is estimated to lower output by about 0.1 percent of GDP per quarter.

- ***The staff's comments are welcome on the possibility of further cuts in expenditures.***

- Under-execution of public investment explained a large part of the lower-than-expected deficit in 2017. Budget under-execution was particularly low in the Ministry of Communications, Infrastructure and Housing (71 percent) and Ministry of Social Affairs (58 percent).

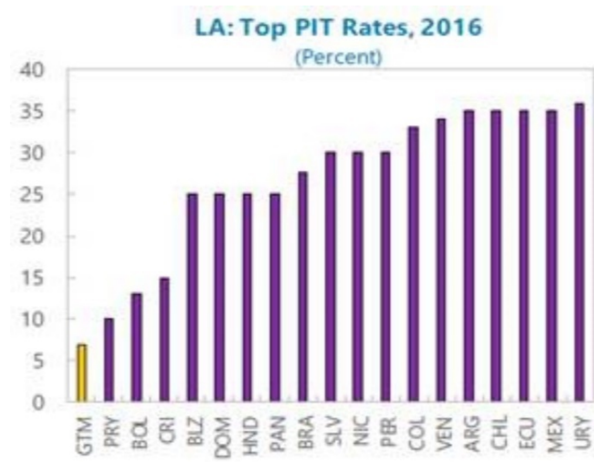
- The authorities are stepping up execution efforts but obstacles facing execution of public investment may persist during this fiscal year. As of April, execution stood at 26 percent, similar to the execution levels observed at the end of April 2017. Execution remains particularly low in the Ministry of Communications, Infrastructure and Housing (7.6 percent) and Ministry of Social Affairs (7.9 percent).

- In 1Q2018, the composition of spending has been biased towards current spending, which increased by 4.2 y/y. Capital spending declined by 2.7 y/y percent. Payment of pensions and salary increases will add to current spending in 2H2018. At the same time, there is hope that the amount allocated to the roads doubled relative to last year, given that given that a significant pipeline of infrastructure projects have gone through a lengthy bidding process.

- ***In the absence of the proposed package and in view of upcoming elections, staff comments are welcome on potential alternative measures to generate additional revenue in the medium-term.***

- Based on extensive TA advice given, one of the measures reported in the table below could be considered in its own right, in the absence of a comprehensive tax reform.

- We would suggest frontloading increases in PIT rates, given very low current levels (5 percent for those earning up to Q30,000 and 7 percent for those earning above Q30,000). The marginal rate of personal income tax of 7 percent is the lowest in the world, and its threshold (equal to 5.3 times the GDP per capita) is the highest in the region.



- The value added tax (VAT) rate of 12 percent is also low compared to 13½ and 15.3 percent in Central and Latin America respectively, although to a lesser extent.

- The excise rate on fuel products has not been adjusted for inflation in 10 years.

- Tax evasion is high by regional standards. Therefore, achieving a higher level of revenues also needs continued tax administration efforts. Efforts should focus on reinforcing VAT controls, with an emphasis on risk-based auditing; strengthening the large-taxpayer office management; improving the use of tax information to correct non-compliance; enhancing tax collection enforcement faculties (including through easier implementation of bank secrecy provisions); and implementing a customs post-clearance audit program to deter non-compliance and facilitate trade. These efforts can yield up to 1 percent of GDP of additional resources.

Tax Policy Options for Additional Revenue Yield

(% of GDP)

Increase in PIT rates (from 2 brackets: 5 and 7% to 3 brackets: 7, 20, and 33%)	0.9
Integrate CIT taxes (integrate gross sales-based regime of 5 and 7% into the net profits-based regime of 25%)	0.2
Increase in VAT rates (from 12 to 15%)	1.2
Phase out PIT exemptions	0.3
Increase excite rate for fuel products (30% gas, 60% diesel)	0.4
Total	**3**

Source: IMF FAD TA, 2016.

- ***In the fall 2017 Fiscal Monitor, staff made the case for a well-designed Universal Basic Income; we wonder whether the team has explored the desirability and feasibility of such an instrument in Guatemala. The staff's comments are welcome.***

- The staff has not explored the desirability and feasibility of a Universal Basic Income (UBI) during this consultation. UBI is a cash transfer of an equal amount to all individuals in a country and, as noted by the 2017 FM, its adoption is a very costly undertaking going well beyond Guatemala's fiscal capacity. Rather, support for tax reform is more likely to be garnered with the resolute implementation of visible and high-impact, spending programs geared at poverty alleviation (60 percent of the population). These include:

- Broadening the coverage of the main conditional cash transfer program *Mi Bono Seguro*. Its small budget dramatically limits its potential to lift the incomes of Guatemala's poor people. The budget of this program has been shrinking since 2012 and it currently amounts to just 0.07 percent of GDP, and covers a mere 20 and 30 percent of the poor and extremely poor population, respectively.

- Expanding, in parallel, basic public goods, such as preventive and primary health care, access to nutrition, water and sanitation services, pre-primary education programs, and maintaining and expanding the roads network.

- ***We understand the authorities focus on increasing expenditure in visible and high impact spending programs. Could staff elaborate on which specific programs the authorities have in mind?***

- The staff will respond to this question during the Board meeting.

- ***According to the 2016 IMF's Fiscal Transparency Evaluation, the elasticity of tax revenue collection to nominal GDP declined from 1.2 percent in the 1998−2007 period to 0.6 percent in 2008−2015. Can staff comment if these estimations have been reviewed? Also, how this low elasticity compares to other Central America countries?***

- A re-estimation of these indicators confirms the elasticities obtained under the 2016 IMF's Fiscal transparency evaluation. Over the more recent 2008−17 period the elasticity increases to 0.8. Similar estimations for Central America countries between 1998 and 2017 yield: El Salvador (1.4), Honduras (1.1), Costa Rica (1.0) and Guatemala (1.0). On a technical note, the numbers reported are tax buoyancy, rather than tax revenue elasticities. Tax buoyancy is defined as nominal tax growth including discretionary measures over nominal GDP growth.

- ***On specifics, we agree with staff's recommendation on mobilizing revenue to facilitate increased investment and improved social outcomes; these are necessary to enable progress towards meeting the SDGs and supporting supply-side expansion over time. However, the sequencing should be considered closely. Would staff comment on their prioritization in this regard?***

- The staff will respond to this question during the Board meeting.

- ***Is there data on income distribution and of public expenditure received by the indigenous population? The staff's response is welcome.***

- Based on the 2009−10 National Survey of Family Income and Expenditure, Lustig (2015) reports Gini coefficients of 0.45 vs. 0.52 for indigenous population and non-indigenous respectively. While inequality among the indigenous population is lower than for the non-indigenous, poverty is way higher for the indigenous (58 percent vs. 29 percent of the population group). The average market income per capita of the non-indigenous population is more than double that of the indigenous population. After all taxes and transfers are considered (including the monetized value of education and health), the ratio of per capita income between nonindigenous and indigenous individuals decreases from 2.13 to 2.03. In all, indigenous people receive 25 percent of the final income in Guatemala.

- Based on executed budgetary data and the local governments portal, a local think tank (the *Instituto Centroamericano de Estudios Fiscales,* ICEFI) reports that 2.2 percent of GDP public spending in 2015 (vs. 12.3 percent of overall public spending), and 1.6 percent of GDP of social spending (vs. 4.7 percent of GDP of overall social spending) goes to the indigenous people. In per capita terms, Guatemala spends USD148 on the indigenous population annually (versus USD328 on the non-indigenous population).

Monetary Policy

- ***On staff's advice regarding the monetary policy stance, we would like to hear from staff if they see any potential financial stability risks of a potentially lowered policy rate in the future.***

- The staff will respond to this question during the Board meeting.

- ***We also note that the BOG needs to be recapitalized. We request staff to clarify the authorities' intention for recapitalization and any prospective impact on the budget.***

- The central bank organic law approved in 2002 provides a framework for the central bank's recapitalization and for its annual loses to be included in the government budget through the issuance of treasury bonds, with no deficit impact. Annual losses were covered with treasury bonds from 2004 to 2011. However, in later years Congress changed this provision in the budget proposal, allocating it to ordinary expenditures instead, but failing to approve the government transfer for this purpose. The issuance of treasury bonds to cover annual losses resumed in 2017 and is expected to continue in 2018 and beyond.

- On the other hand, Congress never approved the issuance of long term bonds with no interest which was supposed to cover the stock of accumulated losses until 2001 and restore the central bank capital, which account for the lion's share of the government liability to the central bank.

- It is important that the government continue transferring resources to the central bank each year to cover the cost of monetary policy (including quasi-fiscal costs) thus improving monetary policy transmission. Since this would be done through the issuance of treasury bonds (below the line) there would be minimal deficit impact limited to interest spending on the outstanding bonds issued for this purpose. To ease liquidity management on the back of large amount of securities coming to maturity, the central bank in recent years extended the maturity of outstanding securities.

- ***We would appreciate staff comments on the slow pace of private credit expansion in recent times, given that there appears to be ample liquidity in the banking sector.***

- Credit developments reflect a combination of supply and demand side factors. By segments, (i) the slowdown in consumption credit reflects some precautionary savings by households on subdued labor market prospects, strong remittance inflows, as well as stricter conditions applied to clients upon the introduction of the credit card law that would cap the interest rates applicable to clients; (ii) the slowdown in credit to large corporates would be related to the improvement in corporate governance regulation along with the completion of large electricity projects financed in FX to large enterprises, which account for about 90 percent of total loans in FX; (iii) the decline in credit for small corporates reflects weak demand along with fears from the lifting of the bank secrecy although the recently adopted microcredit, collateral, and securitization of accounts receivable should greatly facilitate access to credit for this segment going forward; and (iv) the recovery in mortgage loans owes to higher investment in housing by remittance-receiving households.

- On liquidity, liquidity in the banking sector has remained broadly stable over the past 5 years (Quarterly Financial Stability Report, March 2018, SIB). The amount of bank's reserves at the central bank per unit of credit to the private sector remains within normal levels.

Exchange Rate Policy

- ***The staff estimates an undervaluation of 15 percent, compared to the authorities' assessment of the aligned real exchange rate. Could staff clarify the divergence in these estimates?***

- The authorities understand that our undervaluation assessment stems from a CA balance that is stronger than the CA norm implied by medium-term fundamentals. Their estimate of the CA norm and their medium-term CA projections are consistent with staff estimates. The authorities see no significant misalignment in REER once the positive effects of the recent upsurge in remittances and gains of trade on the CA have been accounted for.

- ***In addition, the authorities do not agree with the reclassification of the de facto exchange rate arrangement from "floating" to "stabilized." While we can see merit in reclassification per se, did staff consider a "crawl-like" arrangement, taking into***

account that the nominal exchange rate (quetzals per U.S. dollar) has a long trend of appreciation in an almost monotonic and continuous manner?

- At the time of the last exchange rate assessment, carried out when the policy note was sent to departments, the conditions for a reclassification to a crawl-like arrangement were not met, since there was no trend over the 6-month window used for reclassification. For the purposes of the next evaluation, which will take place at the time of the next article IV or AREAER report, whatever comes first, the *de facto* exchange rate could be reclassified as a crawl-like arrangement if the relevant criteria are satisfied (the exchange rate moves within a ± 2 percent bank around a trend).

- ***Lastly, since the authorities indicated their commitment to reduce FX interventions, does staff plan to reclassify the exchange rate arrangement again if volatility exceeds the 2 percent threshold?***

- Yes, according to the AREAER compilation guide, the exchange rate will be reclassified as floating again if volatility exceeds the 2 percent threshold, provided that there is sufficient evidence that the exchange rate is largely market determined, and moves without an ascertainable or predictable path.

- ***While we would welcome more detail underpinning the reclassification of the exchange rate, we commend the authorities for already widening the margin of their FX interventions.***

- FX intervention in Guatemala is guided by a well-disclosed rule introduced in 2008 meant to moderate the volatility of the nominal exchange rate. Within the rule, intervention is allowed whenever the intraday nominal exchange rate variation deviates by 0.8 percent from the average rate of the previous five-days. The maximum amount that the central bank can buy or sell per day is a total of USD mill 40 distributed in 5 auctions of a maximum of USD 8 mill each. As a gradual process to allow for more exchange rate flexibility, the fluctuation margin has been widened from 0.5 percent in 2008 to 0.8 percent currently.

- In the case of Guatemala, the criteria for a classification as "floating," notably that the exchange rate is largely market determined, do not seem to have been met during 2017, as the observed path of the exchange rate did not show the extent of flexibility that characterizes other arrangements classified as "floating." For details underpinning the reclassification of the exchange rate please see Q16.

- ***We understand that the reclassification is the result of the exchange rate remaining within a margin of less than 2 percent over six-month period and that the***

reclassification carries no judgment on the commitment of the authorities to the flexible exchange rate regime. The staff's comments are welcome.

- Classification as a stabilized arrangement involves three main criteria. First, a spot market exchange rate that remains within a margin of 2 percent for six months or more (to avoid spurious or "noisy" changes in classification in borderline cases, the six-months period can be lengthened by three months, as was done for Guatemala). Second, a notable increase in frequency and size of central bank interventions with respect to total transactions in the FX market during 2017. Third, a regression-based criterion that determines whether the central bank had the intention to stabilize the exchange rate (by purchasing foreign currency when the ER appreciated in the previous day and selling FX when the ER depreciated).

- Guatemala is not the only county in the region with de jure floating or managed floating arrangements whose de facto exchange rate arrangement is classified as stabilized. The reclassification carries no judgment on the commitment of the authorities to the de jure flexible exchange rate regime.

External Sector Assessment

- ***We note that the political and institutional risk indicator for Guatemala has been adjusted as it was considered not consistent with the country circumstances. Could staff provide more details on this adjustment? How has the appropriate level for this indicator been determined? Information on other country cases where this adjustment has occurred would be helpful.***

- Under the EBA methodology, the CA norm estimation includes as a regressor the level of a country's institutional/political risk, measured by an indicator drawn from the ICRG survey data. Higher institutional and political risk would likely discourage investment, resulting in a more positive CA norm.

- The EBA cyclically-adjusted CA norm is estimated to be -3.1 percent of GDP. However, the ICRG indicator used in the EBA model appears out of line with the Guatemala's political and institutional circumstances (it ranks Guatemala at a stronger position than Argentina or Colombia). The staff notes that the ICRG indicator used in the EBA model misses important institutional dimensions that are holding back investment in Guatemala (legal uncertainty, bureaucratic quality, government stability). After adjusting Guatemala's ICRG index to be in line with her peers with similar institutional strength, staff assesses the norm as being closer to 2 percent of GDP. Countries included for peer comparison include Egypt, Pakistan, Ski Lanka, Tunisia, China, Indonesia, Thailand, Russia, India, the Philippines and Turkey.

- Another country case where a similar type of adjustment was performed is Thailand. In the staff report for Thailand, staff also made an adjustment to EBA to better capture the political circumstances of the country. In Thailand's case, the adjustment was made to the coefficient associated with the ICRG index. In our case, we adjust the value of the ICRG index used for the estimation of the CA norm.

- ***Could staff provide the specific adjustment (e.g., we see that Guatemala scored 2.5/6 at end 2017 versus Colombia and Argentina's score of 2/6 – how was this modified)? Why did staff adjust this ICRG variable versus "Investment Profile" or "Corruption," and how does this compare to the political adjustment made in the recent Thailand Article IV discussion?***

- Please see our answer to Q17 above for a detailed explanation of our adjustment and our comparison to Thailand's case.

- The ICRG index used in the EBA model is presented as the difference relative to the GDP-weighted average of the EBA sample. The index for Guatemala for 2016 (latest available from RES) was -0.124, while the ones for Colombia and Argentina were -0.129 and -0.141 respectively. We adjusted the overall ICRG index (including the investment profile and corruption sub-components) for Guatemala to -0.22, to be commensurate with the country's peers (see answer to Q17).

- It is worth noting that, ongoing methodological refinements for the EBA methodology (the results of which were not yet released by the time we prepared the SR), expand the ICRG index to cover seven more components on top of the existing ones.

- ***Could staff discuss why they only used EBA CA and EBA-lite ES, and provide the results for EBA-lite CA?***

- Guatemala is an EBA country. We base our assessment on the EBA CA methodology because Guatemala is not included in the EBA IREER and ES methodologies due to data limitations. For the sake of completeness, we also report the results under the EBA-lite ES approach. The EBA-lite IREER model does not include Guatemala, also due to data limitations.

- The cyclically adjusted CA norm suggested by the EBA-lite CA model is -3.3 percent of GDP (versus -3.1 percent under EBA CA), which suggests the CA gap would be marginally larger by 0.2 percent of GDP under EBA CA.

Financial Sector

- ***Can staff provide information on the strategic orientation of de-dollarization efforts?***

- The share of FX loans to total loans, and FX liabilities to total liabilities, amount to 40 and 30 percent respectively, and about 44 percent of FX loans are extended to unhedged borrowers. Although dollarization hinders monetary policy transmission, and the share of unhedged borrowers represents a vulnerability for the financial sector, the degree of dollarization remains moderate by regional standards. Moreover, the dollarization of assets (credits) began to be reduced as of 2016 and the dollarization of liabilities (deposits) as of 2015.

- The reduction of the dollarization of assets is partly a result of changes in the regulation of capital requirements for loans to unhedged borrowers. In particular, risk weighting on bank loans to unhedged borrowers are currently 40 percent higher than the corresponding weighting on regular loans, and exemptions from this provision initially granted to the electricity and mortgage sectors are being lifted.

- The authorities are planning on taking measures to mitigate vulnerabilities stemming from the maturity mismatches, including by adopting the Basel III Liquidity Coverage Ratio in U.S dollars for monitoring purposes, which would greatly enhance banks' management of liquidity risk.

- The authorities could contemplate further tightening of prudential requirements on FX loans to unhedged borrowers. These could include higher provision, risk-weighting, and collateral requirements, along with enhanced supervision of underwriting standards.

- ***The staff's comments on any concerns related to Correspondent Banking Relationships (CBRs) in Guatemala and their potential impact on remittances are welcome.***

- A LEG/MCM' TA mission conducted in May 2017, determined that Guatemala had experienced quantitative and qualitative non-systemic losses of correspondent banking relationships and services since 2015.

- Correspondent banks remained mostly active even if some accounts were terminated selectively and some restrictions affect the transfer of dollars from and to Guatemalan banks. Nevertheless, these restrictions have not affected the access of Guatemalan banks to foreign bank credit lines and the total amount of remittances, which continues increasing. About 97 percent of remittances are concentrated on the four largest banks.

- ***The staff's comments on the extent of organized crimes and their potential impact on the overall economic performance are welcome***

  There are different estimations regarding the economic cost of organized crime:

- 3 percent of Guatemala's GDP (IDB, *The Cost of Crime and Violence: New Evidence and Findings in Latin America and the Caribbean*). This compares with 4 percent for the Central America region and is also equivalent to the total amount that the region invests in infrastructure. The costs include the social costs of lethal and non-lethal victimization, lost revenue from prison population, private sector expenditure in security, as well as fiscal expenditure on police force and prisons. They do not include indirect costs such as changes in people's behaviors due to fear of crime or the impact on people's health.

- The staff has also used a two-stage least squares method to quantify the impact of homicide rates on GDP based on a large panel dataset for Latin America and the Caribbean. At the first stage, a connection is established between homicides (as the dependent variables) and deportation rates and gun ownership rates (as the explanatory variables). At the second stage, GDP growth is regressed on the instrumented homicide and robberies rates while controlling for other economic or social determinants of economic growth (X_{it}), including PPP-GDP, government consumption, inflation, trade, FDI, years of schooling, population growth, capital account openness, changes in terms of trade, and dummies for legal origin, disaster and war. Results indicate that if CAPDR countries were to bring their homicide rates down to the levels seen in Canada (1.4 per 100,000), GDP growth could be around 0.9 percentage points higher per year for Honduras and El Salvador, 0.7 percentage points higher for Guatemala (homicide rate of 26.1 per 100,000 inhabitants), and at least 0.45 percentage points higher for the other CAPDR countries.

Structural Issues

- ***On the estimation of the impact of corruption on economic growth, we wonder whether the use of a selected sample of countries (maybe the region as it is the case in the recent SIP for Angola's Article IV, or countries with comparable characteristics) would have produced a more focused outcome.***

- In our estimation of the corruption impact on growth, we use a sample of 89 countries including advanced and emerging economies from different regions in order to exploit the cross-country variation on corruption. To control for differences in country characteristics, we include a rich array of control variables, including the log of initial GDP per capita—to control for mean reversion in growth; life expectancy and fertility rate—to control for demographic differences; years of schooling—to capture human capital investment; inflation and government consumption ratio—to reflect macroeconomic stability; and trade openness and change in terms of trade—to capture the effect of external shocks.

- Restricting the sample to only peers in the region (e.g. Central America) would greatly reduce the sample size, degrees of freedom and likely result in low precision of the estimated coefficients.

- ***In this regard, we would appreciate more detailed information on the functioning of the CICIG, including its mandate, sources of financing, and procedures of appointing its management and staff. Could staff elaborate on the role and place of the CICIG among other law enforcement institutions in Guatemala?***

- ***Creation.*** The CICIG was established through an international agreement signed between the Guatemalan Government and the United Nations in 2006. After the Constitutional Court of Guatemala gave a favorable opinion on the agreement, the Guatemalan Parliament ratified it in 2007.

- ***Status and sources of financing.*** The Commission is politically, organizationally and financially independent. It depends directly of the United Nations, more specifically of the Department of Political Affairs. The CICIG is funded through voluntary contributions to a trust fund managed by UNDP.

- ***Mandate.*** The CICIG's mandate consists of three objectives:

- To investigate the existence of illicit security forces and clandestine organizations that commit crimes that affect the fundamental human rights of the citizens of Guatemala, identify the illegal group structures, their modes of operation and sources of financing.
- To collaborate with the Guatemalan Government in the disarticulation of clandestine organizations, promote the investigation, prosecution and sanction of the individuals involved in the illegal groups.
- To make recommendations to the Government for the adoption of policies directed at eradicating these criminal groups.
- CICIG is also authorized to make administrative complaints against public officials and can act as an interested third party in disciplinary procedures initiated against them. CICIG can provide technical assistance to government agencies to fight organized crime.

- ***Procedures of appointing its management and staff.*** The CICIG is led by a Commissioner who is recruited internationally by the UN and appointed by the Secretary General of the United Nations. The Commissioner has the grade of Under Secretary General (USG), and its staff is also recruited internationally.

- ***Role and place of the CICIG among other law enforcement institutions in Guatemala***. CICIG does not operate on its own. Rather, it works with a special unit within the Prosecutor General's Office was created, called the Special Prosecutor's Office against Impunity (FECI). CICIG/FECI cases are decided by High Risk Tribunals, created by Decree number 21-2009 to decide on cases that pose a higher risk to magistrates, judges, prosecutors, and other judicial employees, as well as witnesses, defendants and other actors, which includes organized crime.

- ***Could staff provide the information about the dynamics of the third-party indicators on corruption in Guatemala since 2007 (the year when the CICIG commenced its operations)? We would be interested to learn about changes in the Control of Corruption Index from the WGI and the Corruption Perceptions Index from Transparency International. What is, in the staff opinion, the impact of changes in these indicators on investment and economic growth in Guatemala?***

- For most corruption indicators (including the Control of Corruption Index from the WGI and the Corruption Perception Index from Transparency International), the score shows little within-country variance over time because it is at least partly based on perceptions. For this reason, in our selected issues paper, we run OLS (rather than fixed-effect) regressions to exploit cross-country variation of corruption. Our regression estimates suggest that if Guatemala were to close the governance gap with the sample average, its real per-capita GDP growth could be between 0.2 and 0.8 percentage points higher relative to baseline, depending on the corruption indicator considered.