

Country Program Evaluation

Guatemala

2012-2016

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Guatemala

2012-2016

Office of Evaluation and Oversight (OVE)



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ACRONYMS AND ABBREVIATIONS

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AECID	Agencia Española de Cooperación Internacional para el Desarrollo [Spanish Agency for International Development Cooperation]
AMSA	Autoridad para el Manejo Sustentable de la Cuenca del Lago de Amatitlán [Authority for the Sustainable Management of the Lake Amatitlán Watershed]
CABEI	Central American Bank for Economic Integration
CID	Country Department Central America, Mexico, Panama, and the Dominican Republic
DAAFIM	Dirección de Asistencia a la Administración Financiera Municipal [Department to Assist Municipal Financial Administration]
GEF	Global Environment Facility
INFOM	Instituto de Fomento Municipal [Municipal Development Institute]
MIDES	Ministry of Social Development
MSME	Micro, small, and medium-sized enterprise
NGOs	Nongovernmental organizations
OMJ	Opportunities for the Majority Sector
OPEC	Organization of Petroleum Exporting Countries
PBL	Policy-based loan
PDER	Project to Support the Rural Economic Development Program
PER	Rural Electrification Program
PNC	Policía Nacional Civil [National Civil Police]
REDD	Reducing Emissions from Deforestation and Forest Degradation
RIC	Registro de Información Catastral [Cadastral Information Registry]
SAT	Superintendencia de Administración Tributaria [Tax Administration Superintendency]
SCF	Structured and Corporate Financing Department
SIAF	Sistema de Administración Financiera [Financial Administration System]
SISO	Sistema de Información Social [Social Information System]
SME	Small and medium-sized enterprise
TFFP	Trade Finance Facilitation Program
VAT	Value-added tax

This document was prepared by a team consisting of: José Ignacio Sémbler, Monika Huppi, Oliver Azuara, José Claudio Pires, Maria Fernanda Rodrigo, María Jose Hernandez, Johanan Rivera, Mauricio Torres, and Maya Jansson, under the general supervision of Cheryl Gray (OVE Director). We would like to thank the Bank's Management and staff for their support, and the many public and private sector participants in Guatemala who generously shared their time and insights with the team.



Although Guatemala has experienced relative economic and fiscal stability, tax revenue intake is among the lowest in the region. This has limited the State's capacity to address major issues, including delivery of basic services to a large share of the population.

Executive Summary

CONTEXT

Guatemala is the largest economy in Central America, but has one of the lowest levels of development in the region. Although Guatemala has experienced relative economic and fiscal stability, tax revenue intake is among the lowest in the region. This has limited the State's capacity to address major issues, including delivery of basic services to a large share of the population. Adding to this are challenges of public expenditure efficiency and effectiveness, and constant pressure from natural disasters. Growth has not led to reductions in poverty; in contrast to most countries in the region, poverty has increased over the last decade, affecting 59% of the population, with higher rates of 76% and 79% among the rural and indigenous populations, respectively.

Growth has not been accompanied by quality job creation for the most vulnerable groups, and informality (66%) has declined only marginally over the last decade. Guatemala also exhibits significant lags in different social indicators, particularly the high rates of maternal and child mortality and chronic malnutrition in children under five years of age, the highest rate in Latin America and the Caribbean. In addition, insecurity and violence remain major problems. Although Guatemala has made progress in its process of democratic consolidation, it has experienced a deterioration in almost all governance indicators over the last decade. In a complex institutional setting, in 2015 the country experienced a major political crisis that highlighted problems of transparency.

COUNTRY STRATEGY

The country strategy included a large number of possible areas for cooperation, and placed strong emphasis on rural issues. It identified strategic objectives in six priority areas structured along an institutional axis (fiscal and municipal management, social protection, peaceful coexistence and citizen security) and a rural axis (productive development, health, and transportation). The country strategy identified dialogue areas (education and energy) and other crosscutting topics (climate change, natural disasters, gender, indigenous peoples, regional integration). It also identified private sector opportunities in rural productive development, transportation, logistics, renewable energy, financing for small and medium-sized enterprises (SMEs), low-income housing, and the delivery of basic services.

In general, the strategic objectives were relevant in that they addressed important development issues for the country, as well as government priorities. Nonetheless, the expected results were ambitious in many cases given the difficulties that the Bank has traditionally faced in implementing operations in the country. The selection of priority areas and setting of objectives agreed upon with the government was based on the sector notes and largely on the loans that the Bank planned to approve in 2012 and 2013, or had approved during the design stage of the country strategy. Additionally, under the country strategy guidelines then in effect, the country strategy included limited analysis of the substantial portfolio of operations active at the beginning of 2012. Although the country strategy sought to adopt a cross-sectoral, territorial approach, it lacked substantive analysis of synergies among the Bank's sectors that would allow it to address complex problems in the country, such as rural poverty. With respect to the territorial approach, there was no a priori identification of possible criteria for targeting, nor of any potential institutional challenges or risks to the implementation of this approach.

THE BANK'S PROGRAM FOR 2012-2016

From 2012 to October 2016, sovereign-guaranteed approvals were US\$692.2 million.¹ Approvals of sovereign-guaranteed loans, however, departed significantly from planned levels in response to new demand from the government (mainly for budget support). Consequently, the role of the country strategy and programming documents in guiding the Bank's work in the country was limited, in a context where the Bank showed a great deal of flexibility in responding to the changing requirements of the government. The country continued to use policy-based loans (PBLs) as the main lending instrument (70%).² The two PBLs approved during the evaluation period played an important financial role in the context of high uncertainty and political discord surrounding approval of the country's budgets. As a result, the Bank's program with the public sector was composed mainly of PBLs and a significant portfolio of technical cooperation operations, as well as isolated investment loans in several sectors (approved prior to 2012 but with lengthy execution periods).

The Inter-American Investment Corporation (IIC) approved US\$284 million,³ which was channeled mainly through financial intermediaries (96%) to support SMEs and foreign trade operations. However, the SME support strategy has suffered from limitations. Guatemala's financial system is characterized by a high level of concentration and liquidity. The IIC mainly worked with large banks, a strategy that minimizes credit risk and makes use of the banks' established infrastructure. However, since the money is fungible and the IIC accounts for a minimal share of financing for these entities, there are no established targets for percentages of the portfolio, and there are differences between the IIC and the country with respect to the definition of an SME, this does not necessarily foster competition, and there is no guarantee that funds are channeled to sectors with the greatest financing needs.

The investment loan portfolio continues to suffer from significant implementation difficulties. In addition to lengthy time frames for parliamentary ratification, portfolio execution periods are the longest in the Bank. Various issues are involved, but those of an institutional nature predominate, including high turnover of authorities and staff at the executing agencies and weaknesses in institutional coordination and project management. In some cases there has also been political interference and problems with the integrity of executing agencies. The political crisis in 2015 also affected various operations. Other problems relate to the regulatory framework governing public expenditure execution in the country (including a lack of multiyear budgets and limited annual allocations for projects) and delays due to regulatory inconsistencies and the introduction of new rules to improve spending controls. Thus, there are significant constraints on the execution of Bank operations, and the country's public investment in general. Nonetheless, there are also major design issues on the part of the Bank, including operations with unrealistic objectives; underestimation of costs; complex designs with multiple executing agencies; a lack of clarity regarding project deliverables and execution mechanisms for components; and weak institutional diagnostics and feasibility assessments of operations. Of particular note are problems involving several projects that include infrastructure works.

Despite these problems, there were no major cancellations within the portfolio of loans in execution (US\$24.4 million). There is broad consensus among counterparts regarding the Bank's flexibility in adjusting its operations to new government requirements. This flexibility has certainly allowed the Bank to respond to government priorities and maintain sector presence. Nonetheless, in several cases, changes to execution arrangements and the scope and technical specifications of outputs have affected implementation and the attainment of expected outcomes.

Moreover, though the country benefited from significant amounts of technical cooperation resources, these generally were not used in a strategic manner. Despite the problems in implementing loans, only 10% of approved technical cooperation operations were for operational support. Most technical cooperation operations in the evaluated portfolio were for "client support." Although these were important in some

cases for supporting relevant initiatives, in many other cases they were more scattered and opportunistic efforts with no clear link to strategic objectives or intentions. Adding to this have been implementation difficulties, which have increasingly led the Bank to assume responsibility for executing technical cooperation operations and their respective transaction costs.

Coordination with other donors has generally been positive. The Bank has participated actively in the donor group (G13) and sector working groups, in addition to cofinancing several operations. The main coordination activities were with the World Bank on strategy design and support via policy-based loans. The Bank's role as facilitator has also been important in major initiatives such as the reparations policy for communities affected by the construction of the Chixoy hydroelectric dam and the Plan of the Alliance for Prosperity in the Northern Triangle.

IMPLEMENTATION AND EFFECTIVENESS OF THE BANK'S PROGRAM

Progress toward achieving strategic objectives was generally limited. There were some advances in relation to objectives such as improvements in the tax structure and targeting and coverage under the social protection program, yet important challenges remain. Although there was progress toward planned objectives in other sectors, such as health and citizen security and coexistence, it is difficult to attribute this to Bank support. The main reason for this lies in the fact that several planned loans failed to materialize, while there were also delays and problems in executing active loans.

Although the two PBLs approved during the evaluation period supported a number of important measures, such as fiscal reform legislation and regulation in 2012, most of the policy measures supported were of medium depth. Although they constitute important steps, they require government commitment for their implementation, as well as additional actions, to have a significant impact. The Bank supported the PBLs with technical cooperation operations that mainly facilitated the fulfillment of specific disbursement conditions, although subsequent support for implementing these measures remains a challenge in several areas.

A significant part of the loan portfolio also reflects operations approved prior to 2012; these are scattered in several different sectors and not directly related to the strategic objectives of the country strategy. There have been substantial implementation difficulties in these cases, and despite progress in a number of specific areas such as rural electrification, a cadastre of protected areas, and minor repairs to schools, the results have also generally been limited. Moreover, although a number of important outputs have been produced, there are challenges in terms of sustainability due to factors such as a lack of funding, high turnover among civil servants, limited participation of key stakeholders, and weak governance in some sectors. In this context, implementation of the **territorial approach** envisaged in the strategy was more limited than expected.

Recent efforts through several of the Bank's sector departments to provide basic services to communities in Chixoy have been a positive experience and could lay the foundations for potential Bank interventions in rural areas.

Institutional axis: In **fiscal and municipal management**, the Bank played an important role in designing fiscal reform. The reform was the most comprehensive in recent years, but failed to meet revenue intake targets due to external factors and, in large part, implementation problems (particularly weaknesses in tax administration). Implementation of the diagnostic assessments and proposals financed by the Bank to support the fiscal decentralization process has been limited. The PBL also supported planning instruments, but their implementation needs to be deepened, and linkages to the budget process improved. Support for the Ministry of Finance has generated various ad hoc outputs. A substantial share of the resources under one loan was redirected to support the continuity of the Financial Administration System, which the Bank has been progressively supporting since then. The Bank used a PBL to support several measures to strengthen the **social protection** system, including the incorporation of eligible beneficiaries who had been excluded from the system, and the implementation of actions to strengthen operations and improve targeting. It used technical cooperation operations to facilitate the fulfillment with conditionalities, although support for the implementation of these measures, and strengthening of the conditional cash transfer program in general, remains a challenge. The program continues to face challenges such as a lack of sociodemographic information and monitoring of coresponsibilities on the part of ministries, as well as delays in the delivery of transfer payments. In **peaceful coexistence and citizen security**, the Bank's program was smaller than expected. Objectives have been supported mainly by technical cooperation operations that have had different degrees of progress. The sole loan in execution supports several different entities in the justice sector, and is not directly related to country strategy objectives. Progress under the operation has been limited, owing in large part to its decentralized execution mechanism.

Rural axis: In **productive development**, the program with the public sector was smaller than planned, and the design of the only active loan was ambitious with significant implementation difficulties and limited results. The Multilateral Investment Fund (MIF) provided significant support for rural, low-income outputs. However, these were scattered and isolated, which puts their sustainability at risk. MIF participation would have benefited from a more defined intervention strategy and greater coordination with the public sector area of the Bank within the framework of a rural productive development strategy. In **health**, portfolio implementation has been affected by frequent changes of authorities and staff, as well as capacity limitations, cumbersome bureaucratic procedures, and design problems. Rehabilitation of 10 hospitals was completed (fewer than expected), and a new one was built but is not yet operating due to a lack of equipment, supplies, and staff. It is unlikely that the Bank has contributed significantly to improvements in the objectives, given limited

achievements under investment operations focused on primary care and malnutrition, as well as the scattered and opportunistic nature of the technical cooperation operations. The PBL supported the adoption of a series of technical manuals and regulatory documents that provide the basis for a more efficient primary care system, although these measures will require monitoring and effective implementation in order to have an impact. No operations were approved in **transportation**.

Dialogue areas: In **education**, the Bank continued to execute a program that has undergone significant changes to execution arrangements, with lengthy implementation periods. In infrastructure, progress was made in school repairs, but there were substantial delays to the construction of new classrooms and furnishings. In terms of the quality of education and school management, progress has been seen in relation to book purchases and teacher training, although this has not necessarily been reflected in quality improvements. A new program with a similar structure, approved in 2015, has not yet been ratified by Congress. In **energy**, the Bank has focused on rural electrification. The completed loan was executed swiftly owing to the use of a trust fund as the execution mechanism, and significant gains were made in electricity coverage. Important challenges, however, relate to the sustainability of investments and the implementation of isolated systems. A second phase of the program approved in 2014 has not yet been ratified by Congress.

Other areas: In **water, sanitation, and solid waste management**, substantial resources were canceled under a program for the Lake Amatitlán watershed. A number of outputs were produced, but sustainability is low and there is no evidence that environmental deterioration in the watershed has been reversed. Under the rural water and sanitation program, a change of approach and execution arrangements failed to make allowance for institutional capacities for implementation. As a result, significant problems in implementing works meant that improvements in coverage were less than expected, and substantial challenges remain in terms of institutions and investment sustainability. In the area of **environment and natural disasters**, the main progress has been in the cadastre program for protected areas. A conservation program for the Maya Biosphere Reserve has been affected by the complexity of its design and the difficulty of operating in the Petén region. Although several projects have been approved, these have been characterized by a high degree of fragmentation, and sustainability is a challenge. Two loans in the area of **competitiveness** had ambitious designs, covering a broad number of areas at the institutions supported. The main results have been seen in relation to the internationalization of micro, small and medium-sized enterprises, although execution has not been free from difficulties. The IIC's work with **financial intermediaries** sought to support the SME portfolio, although limitations in the support strategy mean that it cannot be concluded that the resources reached the segments in most need. The **Trade Finance Facilitation Program**, in addition to its growing financial importance for the IIC, supported foreign trade operations totaling US\$492 million.

CONCLUSIONS AND RECOMMENDATIONS

The pattern of growth in the country has not been accompanied by reductions in poverty, which currently affects more than half the population. Institutional weaknesses, together with limited revenue collection and public expenditure effectiveness, are responsible in large part for the difficulties that the State has encountered in addressing this major challenge. Against this backdrop, the Bank has not succeeded in providing the kind of effective support that would have helped to address the structural aspects of poverty. This has been reflected in implementation problems and limited results under the operations. Accordingly, the Bank needs to redefine its strategy for support to the country, with the objective of promoting more significant and lasting changes and outcomes. Based on the findings of this evaluation, OVE makes the following recommendations:

1. In dialogue with the government and financial support, prioritize the structural problems of governance that limit the State's effectiveness. In particular, the State's ability to address the country's major challenges, including the delivery of basic services to a substantial share of the population, is limited by low capacity for revenue collection, weak public expenditure efficiency and effectiveness, and problems of transparency.
2. Restructure and reduce the size of the current portfolio. OVE reiterates the recommendation from the previous CPE, to adjust the size of the portfolio to the country's institutional capacity. In dialogue with the government, operations with significant problems, high transaction costs for the Bank and the country, and those regarded as nonpriority should be canceled. The Bank should also limit extensions to its operations, particularly by not extending projects that have made little progress, and should set specific criteria for the maximum number and time for extensions of the current portfolio.
3. Reorient the use of lending instruments toward achieving results. Given the substantial structural problems in implementation and limited progress in operations, the Bank should explore new results-based mechanisms focused on the implementation of reforms and measures begun with Bank support. The Bank should also play an important role supporting the implementation of these measures and achievement of results, so that they have a more lasting impact.
 - a. Structure the final tranches of PBLs with policy conditions (in the policy matrix) focused on achieving results (rather than actions focused on processes or policies) that encourage the implementation of reforms and measures begun in the early tranches of the PBLs.
 - b. Explore within the Bank the possibility of piloting new results-based approaches or instruments.



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4. Only approve operations with simple designs and more thorough analyses, to help minimize design problems in the current portfolio. If the Bank decides to approve new investment operations, the designs should involve no more than one executing agency, a small number of components with clearly defined outputs and technical specifications. The Bank should also deepen its analysis of both institutional capacities for project management and the legal and technical viability of its operations, including certainty that suitable land is available in the case of infrastructure projects. Additionally, the Bank, in dialogue with the government, should incorporate conditions to ensure greater stability of executing agency staff.
5. Use technical cooperation principally to support the preparation and execution of loan operations. Given the significant implementation problems experienced, approval of technical cooperation operations to support loans should be the priority. If technical cooperation operations are approved to support other priority initiatives of the government and the Bank, these approvals should be more limited and contained, and directly linked to the established strategic objectives and lines of support.

6. Redefine the IDB Group's strategy for private sector support in the country to focus on the main constraints to private sector development, as identified through a specific diagnostic assessment for the country. In the event that SME access to finance is identified as one of these priority constraints, the IDB Group should restructure its current strategy of support through financial intermediaries to target the segments most in need and promote greater competition in the financial system through a better balance of intermediaries supported.

¹ In the context of relations with the new government in 2016, the Bank is planning approvals totaling US\$310 million by end-2016; this would raise approvals for the period to US\$1.0022 billion, exceeding the high lending scenario of US\$900 million.

² If the approvals planned by end-2016 are included, this figure rises to 73%.

³ Includes Structured and Corporate Financing Department (SCF) operations (US\$231 million) and Opportunities for the Majority Sector (OMJ) operations (US\$3 million) approved between 2012 and 2015, prior to the merge-out of the Bank's private sector windows with the IIC.



1

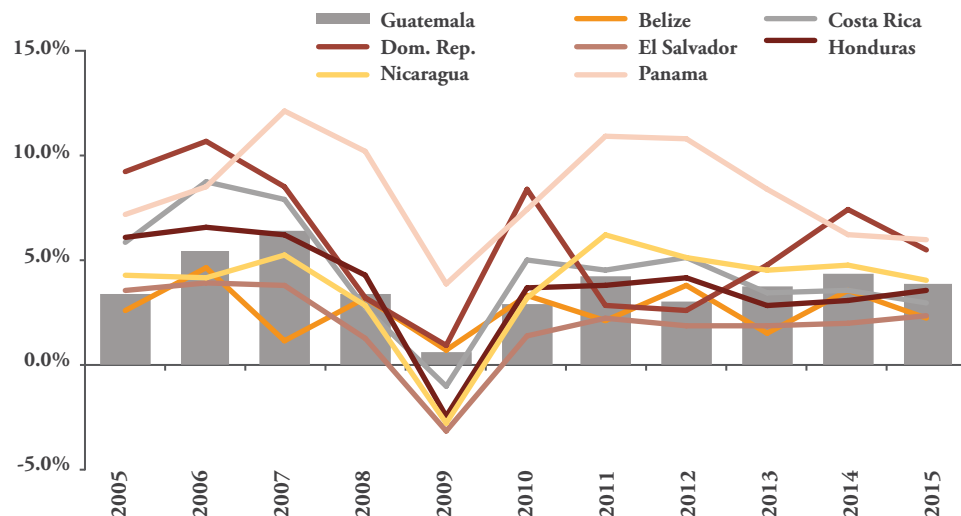
Guatemala's level of human development is low. Despite progress over the last decade, per capita income (US\$7,720 on a purchasing power parity basis) remains below the average for Latin America and the Caribbean (US\$15,467) and is the third lowest in Central America.

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1 General Context of the Country

Guatemala is the largest economy in Central America¹ and one of the least-developed in Latin America and the Caribbean. Guatemala is also the most densely populated country in Central America (16 million inhabitants) with a young, multiethnic population. It has the second-largest indigenous population in Latin America and the Caribbean after Bolivia (38.8%, 2014 National Survey of Living Conditions (ENCOVI)). Although the process of urbanization has accelerated, half the population currently lives in rural areas. Guatemala's level of human development is low.² Despite progress over the last decade, per capita income (US\$7,720 on a purchasing power parity basis) remains below the average for Latin America and the Caribbean (US\$15,467) and is the third lowest in Central America (Figure 1, Annex 1).

Guatemala has experienced moderate rates of growth, but these have been less volatile than in other economies in the region. Real GDP grew by 3.7% per year on average between 2005 and 2015, compared with 4.4% growth in other countries belonging to the Country Department for Central America, Mexico, Panama, and the Dominican Republic (CID), excluding Mexico (Figure 1.1). Guatemala grew by 3.7% on average in the 2012-2015 period, which was higher than the average for Latin America and the Caribbean (1.8%) but lower than in other CID countries (4.2%). Growth has been driven mainly by domestic consumption (Figure 3, Annex I).³ Private consumption is the main contributor to growth (84% of GDP), expanding on average by 4% in the period 2012-2015. This is the result of an expansion in consumer credit (Figure 4, Annex I) and growth in remittances, which accounted for 10% of GDP in 2015 (Figure 5, Annex I).

FIGURE 1.1**Real GDP growth***Source: IMF.*

The relatively stable economic environment is mainly the result of prudent macroeconomic policies. Inflation has remained comparatively low, and within the Central Bank's target band (Figure 6, Annex I). The fiscal deficit has averaged 2% of GDP over the last decade and in the period 2012-2015 (Figure 7, Annex I),⁴ lower than the average for Latin America and the Caribbean (2.7% from 2005 to 2015 and 4.2% from 2012 to 2015). The deficit peaked at 3.3% in 2010 (against the backdrop of the financial crisis in 2008 and natural disasters in 2009), but then narrowed to 1.4% in 2015, mainly as a result of a reduction in public expenditure. Total gross government debt has remained at around 20% of GDP over the last decade, and at 24.5% in the period 2012-2015 (Figure 8, Annex I). This level is low compared to the rest of Latin America and the Caribbean (50.8% in 2015).

Despite fiscal stability, tax revenue intake is among the lowest in the region. This has limited the State's capacity to address major challenges, including providing basic services to a large share of the population. Guatemala has no significant sources of nontax revenue (Figure 10, Annex I), and tax revenue is low compared to Latin America and the Caribbean and other CI countries (10.9% of GDP over the last decade) (Figure 11, Annex I). Tax policy has historically been characterized by political discord and opposition from business sectors, which have prevented significant reforms. An increase in tax exemptions and acceleration of the process of trade liberalization have also led to a decline in import and export tariff revenue and to greater dependence on indirect taxes such as the value-added tax (VAT). An important and long-delayed fiscal reform was approved in 2012; however, expected results in terms of revenue intake failed to materialize (Figure 1.2) due to exogenous factors and (mainly) problems of implementation (see Chapter III and Table 1, Annex I). These were reflected in the corruption problems that led to an institutional crisis at the Tax Administration Superintendency (SAT). Adding to this are significant challenges in terms of the efficiency and effectiveness of public spending, including its rigidity, low

rates of execution, and limited budgetary transparency. Public spending is also under constant pressure as a result of the country's vulnerability to natural disasters such as hurricanes and earthquakes.⁵

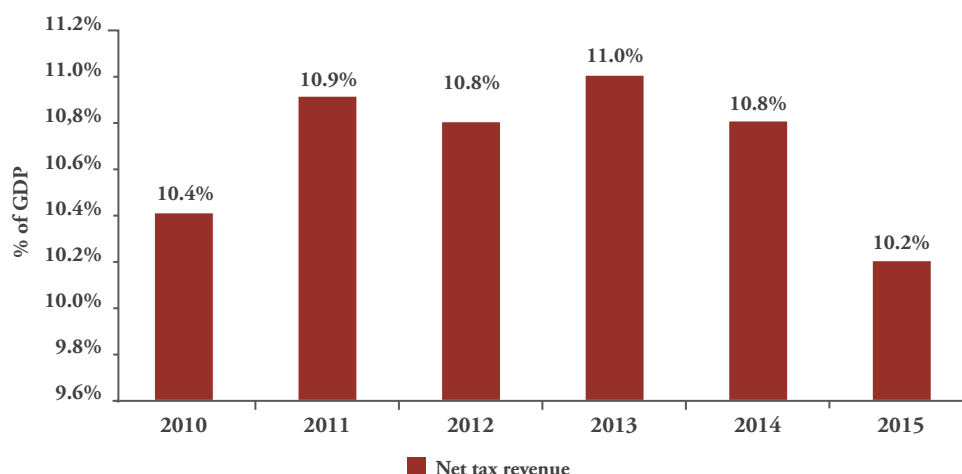


FIGURE 1.2

Net tax revenue

Source: SAT.

Against this backdrop, and in contrast to most Latin American and Caribbean countries, poverty has risen over the last decade. The pattern of growth has failed to reduce poverty. Guatemala suffers from persistently high levels of poverty, with official figures showing poverty rising from 51% to 59.3% between 2006 and 2014,⁶ and extreme poverty rising from 15.3% to 23.4%. The incidence of poverty is higher among the rural population (76.1% versus 42.1%), which has less access to social services, infrastructure, and economic opportunities. Some departments—such as Alta Verapaz and Sololá—have poverty rates of more than 80%. In addition, 35.3% of the rural population suffers from extreme poverty, compared to 11.2% in urban areas. Poverty also affects vulnerable groups such as the indigenous population, which saw its overall poverty rate rise from 75% to 79.2%, and its extreme poverty rate rise from 27.3% to 39.8%. To a large extent, this reflects the fact that growth has not been accompanied by the creation of quality jobs for the most vulnerable population groups. The rate of job creation (2.8%) has been lower than economic growth over the last decade. Informality has also fallen slightly since 2000, and mainly affects the rural population (81.2%), young people (69.9%), and indigenous groups (80.3%).

Guatemala also has the lowest level of social spending in Latin America and the Caribbean and lags behind on various social indicators, with negative consequences for human capital accumulation. In 2013/2014, social spending stood at 7.6% of GDP, little changed over the last decade and lower than the average for Latin America and the Caribbean (29.3%). There are also significant challenges in terms of efficiency and targeting. The average number of years of schooling is 5.6, and the illiteracy rate is 14.4%. The completion rate for primary education rose by six percentage points between 2008 and 2013, although net enrollment declined from 95.2% to 89.1%. Net enrollment for secondary education is low (43%). Significant challenges also

persist in terms of the quality of learning. In the area of health, the 2008–2013 period saw a decline in maternal and under-5 mortality rates; however, these remain among the highest in Latin America and the Caribbean, at 163 and 40 per 100,000 live births, respectively. The prevalence of chronic malnutrition in children under five years of age is also the highest in Latin America and the Caribbean (46.5%).⁷ The sector faces significant institutional weaknesses, reflected in the operational difficulties experienced in implementing health services throughout the country and in delivering supplies and medicines. Access is particularly limited in rural areas, a problem that has intensified with the recent decision to discontinue the use of nongovernmental organizations (NGOs) in service delivery without any alternative structure in place.

Limited spending also affects infrastructure, contributing to the deficits seen in some sectors (mainly in rural areas). Investment in infrastructure (public and private) was less than 3% of GDP from 2008 to 2013, and the condition of infrastructure, particularly in rural areas, constitutes a significant obstacle to growth and investment. Guatemala lags behind in terms of road density, and a substantial part of the road network is in poor condition. The occurrence of climate phenomena is also a constant threat to infrastructure. Access to electricity stands at 69% in rural areas, and at 90% in urban areas. The population with access to improved drinking water sources increased from 72.6% in 2000 to 77.8% in 2014. In urban areas this indicator is 89%, while in rural communities it stands at 64.4%. The population with access to improved sanitation services also improved (from 44.2% to 58.3%), though the gap between urban and rural areas is significant (83% versus 28.9%).

Insecurity and violence also remain major problems. Although the upward trend has been reversed since 2013 (Figure 12, Annex I), Guatemala has the fifth highest rate of homicide in Latin America and the Caribbean (30 per 1,000 inhabitants in 2015). Levels of victimization, unreported crime, and impunity are high. Crime is mainly associated with organized crime networks, gangs, and drug trafficking elements. Violence and insecurity are also leading deterrents to investment and impose significant economic costs.⁸ The context of insecurity and violence in the region has coincided with flows of undocumented migrants to the United States from Central America. From 2013 to 2014, there was an increase in migration flows involving unaccompanied minors. At the end of 2014, this situation led the governments of El Salvador, Guatemala, and Honduras (together with the United States) to sign the Plan of the Alliance for Prosperity in the Northern Triangle, which aims to address the structural roots of the problem and engender medium-term actions (Box 1, Annex I). The IDB serves as technical secretariat of the plan.

Although Guatemala has made progress in terms of democratic consolidation, significant challenges remain in the area of governance. In the 1980s, after more than three decades of civil war and political instability, Guatemala embarked on a process of democratic renewal that culminated in the signing of the 1996 Peace Accords. Since then, Guatemala has made a number of attempts to reform the justice system,⁹

strengthen the rule of law, and reduce corruption. However, the process has been complicated and slow. Guatemala falls below the average for Latin America and the Caribbean on all dimensions of the World Bank's governance indicators, and actually experienced a deterioration between 2004 and 2014 on almost all dimensions (Figure 13, Annex I). Furthermore, the system of political parties is weak and fragmented,¹⁰ and this has hindered consensus and long-term planning. In 2015, the country experienced a major political crisis that highlighted problems of corruption (Box 1.1).

Box 1.1: The 2015 Political Crisis

In April 2015, the Prosecutor's Office and the International Commission against Impunity in Guatemala (CICIG)¹¹ exposed a corruption and customs fraud scandal (known as "La Línea," or "The Line") involving SAT officials and high-level government authorities. This led to widespread demonstrations demanding the resignation of Vice President Roxana Baldetti. In April 2015, President Pérez Molina extended the CICIG's mandate for two years to continue the fight against corruption (it had been set to expire in September 2015). After months of demonstrations and the resignations of several ministers and members of the Partido Patriota party, the Vice President resigned in May 2015 and was subsequently arrested on August 21. On the same day, the Supreme Court initiated preliminary proceedings against President Pérez Molina aimed at removing his immunity and allowing him to be investigated as part of the corruption case. Once stripped of his immunity, Pérez Molina resigned on September 2. On September 3, Alejandro Maldonado was appointed interim president and Pérez Molina was arrested. Presidential elections took place on September 6, as planned, with Jimmy Morales elected in the second round on October 25.

Judicial investigations by the CICIG uncovered a complex money-laundering scheme to raise funds during the Partido Patriota's 2011 election campaign, which continued to operate during the government's 2012-2015 term in office. The CICIG concluded that isolated cases of corruption such as "La Línea" were part of a broader criminal network engaged in money laundering and illicit enrichment that involved several State institutions. This case was called "Capture of the State of Guatemala." Further prosecutions were initiated over the course of the year.

The development challenges mentioned in the chapter are reflected in the significant challenge of attracting investment and improving the business climate. The country ranks 78th out of 140 countries (tenth in Latin America and the Caribbean) in the World Economic Forum's Global Competitiveness Rankings for 2015-2016. The most problematic factors identified are institutions, health, and primary and tertiary education. These difficulties are reflected in poor business perceptions of the costs of crime and violence; corruption; the low quality of education and its impact on labor



Guatemala suffers from persistently high levels of poverty, with official figures showing poverty rising from 51% to 59.3% between 2006 and 2014, and extreme poverty rising from 15.3% to 23.4%.
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force qualifications; inefficiencies of government administration and public spending; and the inadequate supply of infrastructure. Informality and the burden of red tape involved in starting a business also continue to affect the business climate. In terms of access to finance, levels of liquidity and concentration in the financial system are high,¹² and access is unequal depending on the size of the company. In particular, access to finance is limited by the low coverage of credit registry systems, high levels of business informality, and a lack of movable collateral, particularly in the case of micro, small, and medium-sized enterprises (MSMEs).

Despite the major political crisis in 2015, the handover of power was peaceful and economic prospects are favorable. The economy grew by 4.1% in 2015, as private consumption was buoyed by lower energy prices and growth in remittances. In February 2016, Jimmy Morales of the Frente de Convergencia Nacional was sworn in as president. The government's policy agenda for the 2016-2020 period place priority on the fight against corruption. Among the main measures implemented is approval of the Law to Strengthen Fiscal Transparency at the SAT, which includes the strengthening of that agency's corporate governance and new powers to enforce the law, including the ability to lift bank secrecy pursuant to a judicial order. Although no concrete proposal has yet emerged, the possibility of a new fiscal reform is being

discussed. The IMF projects growth of 3.8% in 2016, with risks weighted to the downside due to external uncertainties that could affect trade and the exchange rate. The fiscal deficit is expected to remain stable, although there is a risk of a higher deficit if tax revenue intake does not recover.



The strategy identified opportunities for the private sector in productive rural development, transportation and logistics infrastructure, renewable energy, financing for small and medium-sized enterprises (SMEs), low-income housing, and the delivery of basic services.

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2 The Bank's Program, 2012-2016

The previous evaluation period (2008-2011) was marked by the international financial crisis. Bank sovereign-guaranteed approvals reached an historic high of US\$1.191 billion, consisting mainly of policy-based loans (71%). The Bank established itself as the main source of external financing. The Country Program Evaluation for 2008 2011 (document RE 404) highlighted the alignment of the Bank's program with government priorities. However, a deterioration in execution underlined the country's limited capacity to manage a portfolio of this size. Execution of some projects was also hindered by delays in obtaining congressional authorization for loans, as well as by inappropriate choices in terms of instruments and executing units. Moreover, the attainment of planned objectives was compromised by the inadequate implementation of instruments (for example, waivers under policy-based loans and the redirecting of funds under investment projects to meet emergency needs).

A. RELEVANCE OF THE 2012 2016 COUNTRY STRATEGY

Against a backdrop of economic recovery and high social expectations, Otto Pérez Molina of the Partido Patriota was sworn in as president in January 2012. The government's plan ("Agenda for Change") identified five priority areas of focus with their corresponding objectives: (a) democratic security and justice; (b) competitive economic development; (c) productive and social infrastructure for development; (d) social inclusion; and (e) sustainable rural development. This ambitious development agenda was to be implemented via three major social pacts that would attempt to address significant hurdles to the country's development: the Fiscal Pact, the Zero Hunger Pact, and the Pact for Peace, Security, and Justice.

The country strategy was designed and implemented in a difficult setting, accompanied by a number of strategy shifts that created stumbling blocks for the continuity of the relationship between the Bank and the country. The strategy was approved in December 2012, and its design and much of the strategy period were marked by a difficult institutional context that culminated in 2015 with the political crisis. Compounding this were continual changes in senior officials at the Ministry of Finance as well as Bank Representatives. There were three finance ministers during the government of Otto Perez Molina. Moreover, the Bank changed its country Representative in the first quarter of 2012, and subsequent differences between the Bank and the government over the appointment of a new Representative meant that, up until February 2013, the Bank had only an acting Representative in place. In August 2014, the Bank changed its Representative once more.

The strategy included a large number of possible areas for cooperation, and placed strong emphasis on rural issues. The country strategy focused specifically on “improving living conditions for the Guatemalan population, particularly those living in rural areas,” and it structured the Bank’s work along an institutional axis and a rural development axis encompassing six priority areas in which the Bank set strategic objectives (Table 2.1). The strategy also identified the following crosscutting areas for action: climate change adaptation and mitigation, natural disaster impact mitigation, gender, indigenous peoples, and regional integration. The strategy envisioned the possibility of additional support in dialogue areas (education and energy), if project implementation in these areas advanced significantly. The strategy identified opportunities for the private sector in productive rural development, transportation and logistics infrastructure, renewable energy, financing for small and medium-sized enterprises (SMEs), low-income housing, and the delivery of basic services.

TABLE 2.1: STRATEGIC OBJECTIVES IN PRIORITY SECTORS

AXIS – INSTITUTIONAL	
Priority sectors	Strategic objectives
Fiscal and municipal management	Improve the pattern of taxation
	Improve budget planning and execution capacity
	Strengthen the fiscal capacity of municipalities
Social protection	Improve the targeting and target population coverage of social protection programs
Peaceful coexistence and citizen security	Strengthen the National Civil Police institutionally in such areas as career policing, personnel training, and control of police misconduct
	Improve the quality and results of criminal investigations
	Reduce the vulnerability of women and young people to violence and crime
AXIS – RURAL DEVELOPMENT	
Priority sectors	Strategic objectives
Productive development	Create opportunities to improve incomes from productive activities for the rural population
	Diversify sources of income of rural households
Health	Reduce under-5 chronic undernourishment in rural areas
	Reduce child mortality in rural areas
	Improve maternal health in rural areas
Transportation	Expand the rural road system
	Improve the infrastructure quality of the rural road system

Source: Country Strategy with Guatemala 2012–2016 (document GN 2689).

The strategic objectives were generally relevant, although expected results were ambitious in many cases given the difficulties that the Bank has traditionally faced in implementing its operations. The objectives addressed important development issues and were aligned with government priorities. The selection of priority areas and setting of objectives agreed upon with the government was based on the sector notes and largely on the loans that the Bank planned to approve in 2012 and 2013, or had approved during the design phase of the country strategy.¹³ Under the country strategy guidelines then in effect, the country strategy included limited analysis of the substantial portfolio of operations active at the beginning of 2012 in such areas as water and sanitation, education, and energy, where the country strategy did not call for diagnostic assessments or identify lines of support and objectives. As a result, a number of outcomes of the country strategy would be difficult to attribute to Bank support, considering the execution time for projects in the country.

The country strategy sought to adopt a multisector, territorial approach in the rural sector, but its design was subject to limitations. Diagnostic assessments, strategic objectives, and possible actions to support these objectives were sector-specific, based on the sector notes of the Bank divisions. As a result, the country strategy had only limited analysis of the potential synergies needed to address complex problems faced by the country, such as rural poverty. With respect to the territorial approach, there was no a priori identification of any possible criteria for targeting,¹⁴ nor of any potential institutional challenges or risks to the implementation of this approach.

B. PROGRAM IMPLEMENTATION

1. The Bank's program, 2012-2016

Between 2012 and October 2016, approvals of sovereign guaranteed loans totaled US\$692.2 million, mainly in the form of policy-based loans (PBLs). The Bank approved four operations in the areas of fiscal and municipal management (one hybrid PBL, US\$237.2 million),¹⁵ social (one PBL, US\$250 million), energy (one multiphase investment loan, US\$55 million), and education (one specific investment loan, US\$150 million). In the context of relations with the new government in 2016, the Bank plans to approve two loans totaling US\$310 million in late 2016 (Figure 2.1);¹⁶ this would increase approvals to US\$1.0022 billion, channeled mainly through PBLs (73%) and exceeding the high lending scenario of US\$900 million.

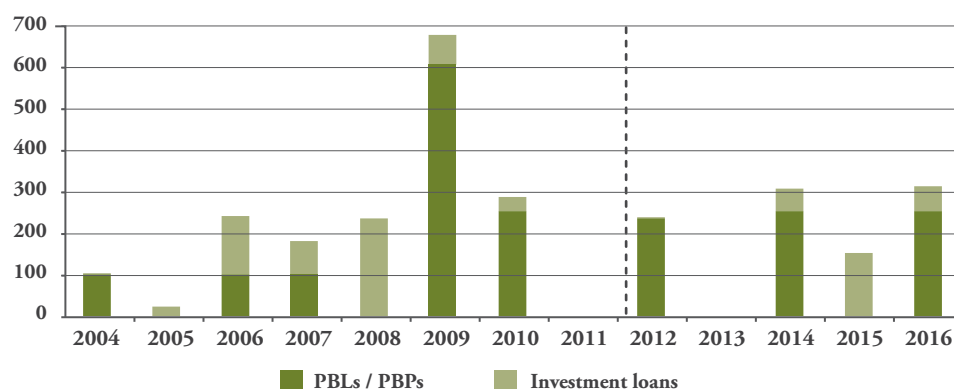


FIGURE 2.1
Sovereign guaranteed loan
approvals (2004-2016)*

Note: *Pipeline A operations to be approved in November and December are included for 2016. Original approved amounts as of August 2016.
Source: OVEDA.

Sovereign-guaranteed loan approvals departed significantly from planned levels in response to new demands from the government (mainly for budgetary support). The two investment loans were approved in dialogue areas that lacked diagnostic assessments and strategic objectives in the country strategy, although they did continue operations being executed by the Bank. In addition, the two loans were approved in December 2014 and 2015, even though the country strategy envisaged a front-loading of approvals in the initial years, so that execution would begin during the strategy period and they would coincide with the political cycle. Neither of the operations has been ratified yet by Congress. The degree to which the program was implemented as planned was low (Table 2, Annex I). Of a total of eight loans included in the programming exercises from 2012 to 2015, only the education loan was approved as planned. Though the approved PBLs had a direct relationship with the strategic objectives, they had initially been planned as investment loans.¹⁷ Consequently, the role of the country strategy and programming documents was limited in guiding the Bank's work in the country.

As a consequence, the Bank's program with the public sector was composed of the PBLs and a substantial portfolio of operations that had been approved prior to 2012, and for which execution had been prolonged. At the beginning of 2012, the portfolio comprised 18 operations approved in 10 sectors, with an undisbursed balance of US\$574 million.¹⁸ The balance was concentrated mainly in the sectors of environment and natural disasters (27%), education (21%), water and sanitation (13%), health (12%), and energy (9%). Forty-one percent of the active portfolio had seen extensions to the disbursement period, averaging 37.5 months. Three loans—in health, water and sanitation, and competitiveness—had still not been ratified by Congress.

The Bank also approved significant amounts of nonreimbursable funding. From 2012 to August 2016, the Bank approved 51 nonreimbursable technical cooperation operations for US\$20.4 million, with Guatemala receiving the second highest amount of technical cooperation funding in Central America over the period. Approved amounts were mainly concentrated in the areas of environment and natural disasters (27%), health (20%), and identity and gender issues (14%). One-third of the resources came from the Fund for Small and Vulnerable Countries. At the beginning of 2012, there were also 30 technical cooperation operations with an undisbursed balance of US\$6.5 million. In 2013, the Bank also approved a second investment grant (US\$6.9 million) within the framework of the Mesoamerican Health Initiative.

Meanwhile, the IDB Group's private sector windows have played an active role, mainly through financial intermediaries. The IIC¹⁹ approved US\$284 million between 2012 and August 2016, mainly in the sphere of financial services (96%). This consisted of six loans focused on SME financing (US\$134 million) and eight operations associated with credit lines under the Trade Finance Facilitation Program (TFFP) program (US\$150 million). A further two operations were approved in energy (US\$13 million) to finance hydroelectric plants in the north of the country. The Multilateral Investment Fund (MIF) approved 16 operations for US\$13.5 million, focused mainly on supporting rural producers.

Nonetheless, the SME support strategy has been subject to limitations. Guatemala's financial system is characterized by high levels of concentration and liquidity. The IIC works with six banks, four of which rank among the five largest in the system in terms of assets. Although this strategy minimizes credit risk and makes use of the banks' ample infrastructure, money is fungible and the IIC accounts for a minimal share of financing for these entities. Moreover, there are no established targets for percentages of the portfolio, and the IIC and the country differ on the definition of an SME. As a result, the strategy does not necessarily foster competition and there is no guarantee that funds are channeled to sectors with the greatest financing needs.

2. Financial importance of the Bank's program

In contrast to the previous evaluation period, the total net flow of IDB capital has been negative. Between 2008 and 2011, the flow was positive (US\$407 million) as a result of the substantial financial support provided in the form of fast-disbursing PBLs during the international financial crisis. Against a backdrop of more favorable economic conditions and greater access to international financing,²⁰ the flow to the country was negative between 2012 and the first half of 2016 (US\$94.8 million), with the key exception of years in which there were PBL disbursements (Figure 2.2). PBL disbursements totaled US\$584 million, while those for investment loans stood at US\$250 million.

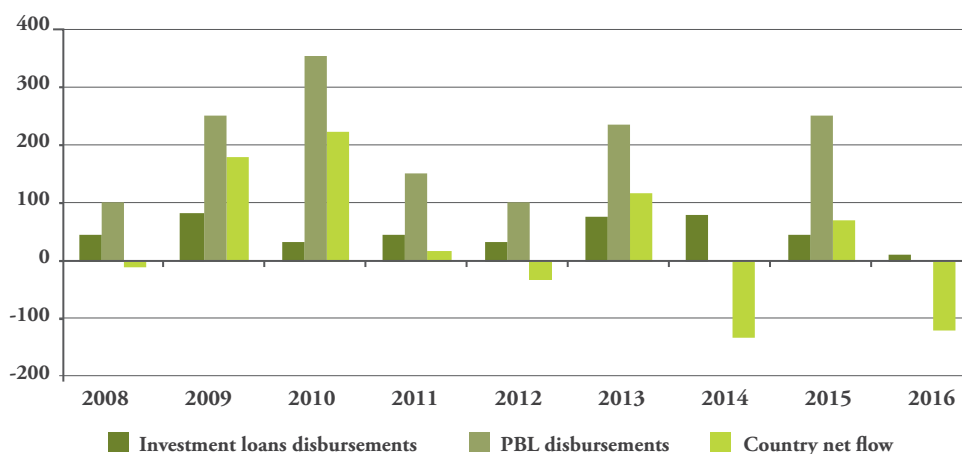


FIGURE 2.2
Disbursements and
Net Capital Flows
(2004-2016)

Note: Disbursements and flows to August 2016.
Source: IDB Finance Department and OVEDA.

The IDB reduced its share of the country's external debt but remained the main multilateral institution in terms of lending. Increased financing in the form of international bonds (which rose from 11.2% of the external debt stock to 30.1%) caused the IDB's share of the external debt to fall from 38.8% to 30.2%. The World Bank approved US\$546 million, mainly in the form of two Development Policy Loans (96%), resulting in a decline in its share of the external debt (from 24.8% to 21.3%), as well as in its investment portfolio and overall presence. The Central American Bank for Economic Integration (CABEI), which also has substantial activity in the country (12.9% of external debt), approved US\$892 million in sovereign-guaranteed loans to finance roads and social and productive infrastructure.

Nonetheless, IDB financing was important in helping to bridge financing gaps in a context of intense uncertainty surrounding the budget. IDB lending costs remain more competitive than the country can access on the international market and from other bilateral and multilateral agencies. The two PBLs were approved quickly so that they could be included in the proposed budgets for the following years; however, there was uncertainty over whether they would be disbursed given the high level of political discord surrounding approval of the annual budgets. The fiscal PBL was prepared in three months and approved by the Bank in August 2012. Although the 2013 budget was approved, Congress did not approve external loans until November 2013 (including IDB and World Bank operations for US\$234 million and US\$200 million, respectively). The contract was finally signed in December 2013, and the two tranches were disbursed that same month, as the policy conditions had already been met. This allowed the expected gap to be bridged. The PBL in the social area was prepared in six months and approved by the Bank in October 2014. Congress failed to approve the budget that year, and as a result the government had to adhere to the 2013 budget. This situation, in addition to lower revenue collection, led to a financing crisis. Congress approved the budget for 2015 in November 2014, allowing disbursements under loans from the IDB (US\$250 million) and World Bank (US\$340 million) in 2015.

3. Operational features of the Bank's program

The country has historically exhibited a marked preference for policy-based loans. Over the last decade, Guatemala has received the highest share of sovereign-guaranteed financing through policy-based loans of any Bank member country (72%). From the government's perspective, in addition to the ability to access countercyclical financing in times of economic turbulence, the main advantages of this instrument lie in the flexibility that the funds provide in the context of high budget rigidities, as well as lower transaction costs. Moreover, given changes in political leadership, shifts in priorities, and extended time periods for obtaining congressional ratification of loans, the country has preferred to use multitranche PBLs, rather than programmatic policy-based loans.

In general, the conditionalities included in the PBLs were of medium depth. In contrast to the previous evaluation period, the design of the two approved PBLs did not include any waivers for disbursements. OVE found that 21% of the policy measures were of sufficient depth to bring about significant changes. Meanwhile, 71% were of medium depth, and a further 7% were of low depth. Thus, although most of the measures constituted important steps, they require government commitment for their implementation, as well as additional actions, to have a significant impact (see Chapter III).

Both PBLs were accompanied by Bank technical support, which facilitated fulfillment of the necessary disbursement conditions, although the implementation of such measures represents a challenge. In the fiscal area, the Bank performed an important role in designing the reforms under previous governments; however, the main challenges

were experienced in their implementation, including weaknesses in tax administration. A technical cooperation operation also supported analytical outputs in the area of municipal finance that served to meet PBL conditions; however, the implementation of these outputs has been scant to date. In the case of the PBL in the social area, the Bank approved technical cooperation operations that helped the country to fulfill specific conditionalities, including process evaluations, proposed improvement plans, and evaluation methodologies. However, the Bank's support for implementation of these improvement plans or recommendations remains a challenge (see Chapter III).

The investment loan portfolio continues to exhibit significant implementation difficulties. In addition to lengthy time frames for the parliamentary ratification of loans,²¹ portfolio execution periods are the longest in the Bank. From the end of 2011 to June 2016, the age of the active portfolio (as measured from the time the loan contracts entered into force) rose from 4.6 years to 5.9, which is the oldest in the Bank (Figure 2.3). As of June 2016, the disbursement period had been extended for 50% of operations. The average extension was 47 months, and in some cases it exceeded 55 months. As a percentage of the undisbursed balance for the previous year, disbursements averaged 16% over the period 2012 2015. Against this background, execution costs (per US\$1 million disbursed) rose 60% from US\$45,396 (2008 2011) to US\$72,692 (2012 2015).

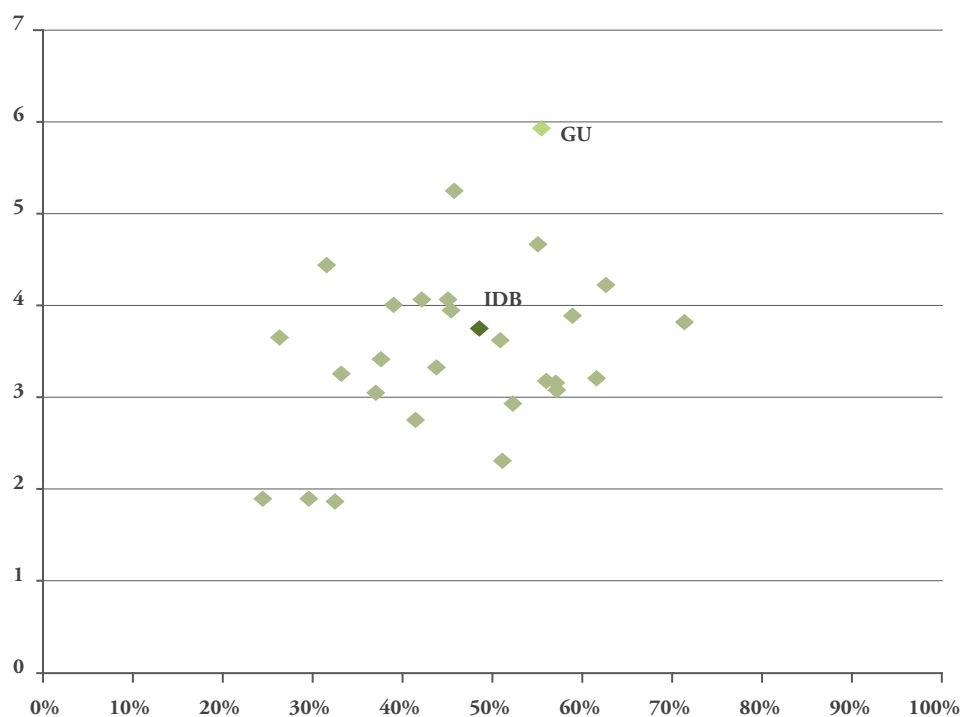


FIGURE 2.3
Age of the portfolio versus
percentage of the portfolio
disbursed

Note: Data to August 2016.
Investment loans with contract
in force.
Source: OVE, using the Bank's
Data Warehouse.

The issues affecting portfolio execution are varied, with institutional factors predominating. Constant turnover among the leadership and staff of executing agencies has affected almost the entire portfolio and intensifies during periods of government

changeover. In addition to stagnation in portfolio execution, this situation has affected the level of ownership on the part of institutions, as a project that is a priority for one administration is not necessarily a priority for a different administration. Adding to this are significant weaknesses in terms of interinstitutional coordination and project management (e.g. the planning, contracting, monitoring, and supervision of deliverables). In some cases there has also been political interference in the institutions responsible for projects, and substantial issues of integrity (e.g. water and sanitation). The political crisis in 2015 also affected the execution of various operations.

The regulatory framework governing public expenditure execution also affects implementation. The lack of a multiyear budget for projects and limited annual allocations have been recurring problems. The complexity of the regulatory framework has also created a number of inconsistencies. A lack of confidence arising from the possibility of conflicting rules and additional requirements on the part of the Office of the Comptroller General has led a number of institutions to implement procedures (in addition to those of the Bank) aimed at complying with national laws and safeguarding their position. New rules have been introduced with the objective of improving expenditure controls, such as the National Public Investment System (SNIP) in 2010 and amendment of the Organic Budget Law in 2013,²² implementation of which has been delayed.

Execution of Bank operations and, generally, public investment in the country are hindered by significant structural constraints. The Bank has actively participated in training the executing agencies, although the impact has been limited given high staff turnover. With the new government in 2016, the Bank has intensified its work with the Ministry of Finance through periodic roundtables focused on resolving any transactional problems that emerge. Although some recommendations from Bank-financed consultancies to identify execution bottlenecks were included in the changes to the budget law, there have been no substantial improvements in execution. The use of a number of alternative execution mechanisms—such as the use of a trust fund for rural electrification projects or the participation of parents' associations in minor school repairs—have helped to expedite the execution of components in specific operations (see Chapter III).

Nonetheless, there have also been significant problems in the Bank's design of operations. Design problems are varied (see Chapter III), and have included operations with unrealistic objectives and execution periods; underestimation of costs; complex designs involving multiple executing agencies; components with a lack of clarity regarding deliverables and technical specifications (due to execution weaknesses or a lack of operating manuals and guidelines); and weak diagnostic assessments that have translated, in some cases, into subsequent legal blocks to execution (e.g. land that is unavailable or lacks clear title, inadequate choice of executing agency). Adding to this have been weaknesses in institutional assessments, particularly concerning the capacity of institutions to manage projects. Of particular note are problems in infrastructure works (Box 2.1).

Box 2.1: Principal problems in infrastructure works

The main problems are seen in the pre-investment phase, including designs that are still in their initial stages at the time of loan approval; unrealistic expectations regarding the availability and status of lands; and the underestimation of costs (or cost structures that are out of date by the time bidding processes are launched). There have also been weaknesses on the part of contractors (e.g. water and sanitation), and in the capacity of some institutions to design and execute complex works where infrastructure is not their main activity (e.g. health, justice, landfills). In a number of projects (e.g. water and sanitation), the participation of key stakeholders—such as municipios or beneficiaries responsible for maintenance—has been limited. This has affected sustainability, a problem that has been aggravated by a lack of resources (e.g. health), weak preventive supervision, limited payment capacity in rural communities, and a lack of cost-recovery mechanisms (e.g. water and sanitation, electrification), as well as weak governance and a fragmentation of responsibilities in some sectors (e.g. water and sanitation, environmental recovery in the Lake Amatitlán watershed).

Despite significant execution problems, there have been no major project cancellations. There is broad consensus among the counterparts regarding the Bank's flexibility in adjusting its operations. Adjustments include changes in execution agency and execution mechanisms, the reallocation of funds among components and projects, and modifications to the scope of outputs and technical specifications. As in the previous evaluation period, resources under several loans were redirected to emergencies. Loan cancellations during the period totaled US\$24.4 million (4.4% of the undisbursed balance at the beginning of 2012), corresponding to two water and sanitation projects for which execution remained unfeasible despite several extensions. This flexibility allowed the Bank to respond to government needs and maintain sector presence. Nonetheless, changes to execution arrangements and the scope and technical specifications of outputs have affected implementation and the attainment of expected outcomes in several cases (e.g. health, water and sanitation).

Although the country benefited from significant amounts of grant resources for technical cooperation, these were not generally used in a strategic manner. Despite significant problems in implementing loans, only 10% of approved technical cooperation operations were for operational support. Most technical cooperation operations in execution in the evaluated portfolio were for client support. Though in some cases these have supported important initiatives (e.g., support for communities in Chixoy, REDD+ strategy), in many other cases they were more scattered and opportunistic efforts with no clear strategic intention or link to strategic objectives (e.g. nutrition). Adding to this have been difficulties in implementation: technical cooperation operations have been affected by problems in institutions (e.g. high turnover among senior and other staff), regulations, and

design (e.g. inadequate choice of executing agency, legal barriers). This situation has led the Bank to assume increasing responsibility for execution and the respective transaction costs. Over the 2012-2016 period, the proportion of technical cooperation operations executed by the Bank rose to 57%, compared to 13% in the 2008-2011 period.

Lastly, implementation of the territorial approach envisaged in the strategy was more limited than expected. Progress under the approach was affected by a failure to approve planned operations (e.g. transportation, productive development), problems in executing active loans, and institutional difficulties specific to work in the rural sphere. Moreover, the Bank's rural interventions have had different criteria in terms of targeting and territorial scope, limiting the potential impact. Recent efforts through several Bank units to provide basic services to communities in Chixoy (Baja Verapaz, Alta Verapaz, and Quiché) have been a positive experience and may lay the groundwork for potential Bank interventions in rural areas.

4. Coordination with other development agencies

The main coordination activities took place with respect to the World Bank, in the areas of strategy design and policy-based loan support. Although the World Bank's strategy was approved four months ahead of the Bank's, preparation of the strategies was coordinated. Joint actions were also envisaged to address the main obstacles affecting investment loan execution, though activities in this area fell short of expectations given lower government demand for this type of financing and the closure of operations by the World Bank. In the case of policy-based loans, results matrices and the financing package (US\$1.008 billion) were coordinated. IDB and World Bank technical assistance has also been important in the area of taxation and, more recently, in the proposal to strengthen governance at the SAT (with the IMF). The involvement of the IDB and World Bank as facilitators was important for the reparations policy for communities affected by construction of the Chixoy hydroelectric dam (Box 2, Annex I). IDB support has also been important for the Plan of the Alliance for Prosperity in the Northern Triangle.

Coordination has generally been positive, though there has been some overlap in areas with high development partner involvement. The Bank has participated actively in the donor group (G13) and in sector working groups. It also cofinanced operations in water and sanitation with the Spanish Agency for International Development Cooperation (AECID) and the Organization of Petroleum Exporting Countries (OPEC), in environment with the Global Environment Facility (GEF), and in productive development with the World Bank. AECID, OPEC, and GEF administered by the Bank expanded the scope of operations, while coordination under the project with the World Bank is reported by stakeholders to have been positive, despite problems in execution. The International Finance Corporation and the CABI have operations with a number of the same intermediaries as the

IIC, although there have been no cofinancing initiatives.²³ The clearest overlap was in health, in the framework of the Mesoamerican Initiative, where a lack of coordination led in some cases to a duplication of activities and oversupply of certain medications, and in other cases to scarcity. Security and justice is another sector with high development partner involvement. However, the Bank has focused on infrastructure, while other partners have supported areas such as violence prevention, sector reform, criminal investigation, and support for the CICIG and the Prosecutor's Office.



In terms of the quality of education and school management, the main progress has been seen in book purchases and teacher training, although this has not been reflected in quality improvements.

3 Implementation and Effectiveness of the Bank's Program

This chapter looks at the implementation progress and outcomes of the loan and technical cooperation program in 2012-2016. It includes operations approved between 2012 and August 2016, together with others that were approved before then but still had significant undisbursed balances at the beginning of 2012. In areas where the country strategy established strategic objectives, progress toward these objectives is also discussed. Although transportation was a priority area, no operations were ultimately approved.²⁴ The program also includes several operations in areas that were not included in the country strategy. For further details of the implementation and results of the operations presented here, as well as other, isolated operations in areas such as modernization of the State, urban development, and indigenous peoples, see Annex II.

A. INSTITUTIONAL AXIS

1. Fiscal and municipal management

The Bank established three strategic objectives: (i) improving the pattern of taxation; (ii) strengthening the fiscal capacity of municipalities; and (iii) improving budget planning and execution capacity. The objectives were directly related to the PBL (GU-L1064) approved months before the strategy, which included policy measures in these three areas. In the municipal area, the Bank also supported analytical outputs to support fiscal decentralization (GU-T1158) and financial management in the Municipio of Guatemala (GU-T1147, GU-T1221). The latter was more of an isolated initiative, but it has helped to create a framework for results-based management in the municipio. The program also includes several operations to support the Ministry of Finance. Although these have yielded several outputs, they have been ad hoc in nature,

lacking a comprehensive framework (Box 3.1). A substantial part of the resources under one loan were redirected to support the continuity of the Financial Administration System (SIAF), which the Bank has been progressively supporting since then.

Box 3.1: Support for the Ministry of Finance

A loan was approved in 2008 (GU-L1031, US\$8.5 million) to modernize the Ministry of Finance by strengthening a large number of the Ministry's departments. The loan suffered significant delays, as it underestimated the institutional capacity of the departments supported, as well as the high rate of turnover among authorities and staff. The change of government in 2012 also led to the elimination of the Vice Ministry of Transparency, which had been created with Bank support (GU-T1102). There were difficulties at the outset in determining the role of the executing agency and its location, a situation that was aggravated by the lack of an operating manual as a condition precedent to the first disbursement. The products included the upgrading of furnishings to preserve files; the formulation of legislative and regulatory proposals to strengthen public financial management and improve its transparency; and the creation of a customer service center, a Single Records Management System, IT tools, and technology platforms for data intelligence. Although a number of outputs have facilitated greater control and transparency in services and specific improvements to management, there is no conclusive evidence that the program has had a significant impact on overall management of the Ministry. In parallel, the Bank approved a technical cooperation operation (GU-T1102) in 2012 to strengthen human capital in the ministry. This was subject to significant delay, owing mainly to the legal infeasibility of one of its components. Staff training and education (through grants for Masters' degrees abroad) were modified in scope, with more specific courses offered in Guatemala. Though the number of beneficiaries increased, it is unclear whether one of the medium-term impacts—attracting new talent—will be achieved. The Bank approved a new special extension to allow remaining funds to be used for procurement training.

In 2012, after World Bank support for the SIAF had ended, 60% of funds under the loan were redirected, at the government's request, to provide continuity to operation of the system within the structure of the ministry. The project was not reformulated, and support for the SIAF was financed under the transparency component, using funds reallocated from the internal improvement component. The funds were used for hardware, software, and more than 100 consultants assigned to the operation. According to the Project Completion Report, these consultants were largely absorbed by the Ministry of Finance in 2014. In 2013, the Bank approved a technical cooperation agreement (GU-T1228) to support the conceptual design of a new SIAF, implementation of which is expected to be supported by a loan (GU-L1097, US\$30 million) included in the 2017 B pipeline.

Progress was made toward the objective of *improving the pattern of taxation*, but the target for revenue collection under the reform was not met, due to external factors and—in large part—problems during implementation. The PBL included approval of the law related to the 2012 reform, together with its accompanying regulations. Although the law had already been passed at the time the PBL was approved, the Bank performed an

important role with respect to its design under previous governments. The reform was the most comprehensive in recent years, including measures to expand the tax base, reduce evasion, and simplify the tax code. From 2012 to 2013, collection rose from 10.8% of GDP to 11%, but fell to 10.2% of GDP in 2015. The income tax—one of the main taxes affected by the reform—rose from 2.7% of GDP to 3.1% between 2012 and 2014, and in 2015 it fell to 2.8%. Weaknesses in tax administration were one of the main factors affecting collection, reflected in institutional problems at the SAT (a key stakeholder that was not included in the reform). Other factors were lower VAT collection due to the weaker external sector; constitutional challenges submitted by the private sector and the opposition; and the reversal of a number of measures by the government. The other conditionalities were of lesser depth (international taxation agreements and creation of an international tax unit), and had been met at the time the PBL was approved.

Progress toward the objective of *strengthening the fiscal capacity of municipalities* has been curtailed by scant implementation of diagnostic assessments and proposals. A technical cooperation agreement approved in 2010 (GU-T1158) financed analytical studies that helped to eliminate the important knowledge gap concerning the municipal financial situation; it also financed proposals surrounding the organization and functions of key entities. Several outputs supported compliance with PBL conditionalities, e.g. a debt quantification methodology and the preparation and approval of guidelines for the Dirección de Asistencia a la Administración Financiera Municipal [Department to Assist Municipal Financial Administration] (DAAFIM) and the Instituto de Fomento Municipal [Municipal Development Institute] (INFOM). The Bank was the main proponent of including conditionalities in this area, given weaknesses in institutional and borrowing frameworks and due also to the work that it had been doing. According to the Project Completion Report for the PBL, the municipios' debt-to-own-revenue ratio fell from 84% to 63% between 2011 and 2013. Nonetheless, no more recent indicators are publicly available, and it is difficult to attribute these outcomes to Bank support given slow progress in the fiscal decentralization process. The Bank supported the operationalization of DAAFIM, but the department still needs to be strengthened. The organizational reform and strengthening of INFOM remains pending. The technical review committee included in the PBL was intended to support these processes; however, the execution of this operation is restarting due to coordination difficulties between the agencies involved, as well as turnover among Ministry of Finance staff, the 2015 political crisis, the transition of government, and the lower political priority placed on this issue within the government's fiscal agenda.

Progress was made toward the objective of improving budget planning and execution, but implementation of these instruments needs to be deepened and linkages to the budget process improved. As part of the PBL, the Public Expenditure and Financial Accountability Assessment (PEFA) was updated in 2012, together with a medium-term fiscal framework (2012-2016) that includes fiscal projections and general guidelines governing borrowing. Although this framework is an important step, its link to annual allocations is still weak and there is a need to move toward a multi-year budget. Based on the results of the PEFA, a pilot project involving results-based management was implemented in the health

sector. While the project achieved its targets for reorientation of the budget, there is no evidence that results-based budgeting practices have been systematically adopted in other institutions.

2. Social protection

The Bank established the objective of improving the targeting and target population coverage of social protection programs. In 2012, the new government decided to create a Ministry of Social Development (MIDES) with the objective of institutionalizing social policy, including social protection programs. The name of the conditional cash transfer program, which had been created in 2008 with Bank financial support (see Annex II), was changed to “Mi Bono Seguro” [My Reliable Payment]. One of the components in the social PBL approved in 2014 (GU-L1085) focused on consolidating operational and management tools for strengthening Mi Bono Seguro.

The PBL component included measures of medium to high depth. The Bank facilitated compliance with disbursement conditionalities, but support for the implementation of these measures—and strengthening of the program in general—remains a challenge. The measures of greatest depth related to the inclusion of eligible beneficiaries that had been excluded from the system due to their lack of a single identity code, as well as the creation and operation of an analytical model for the Social Information System (SISO) to determine payment coverage, and the implementation of actions to strengthen operations (modification of program parameters and organizational changes) and improve targeting. Other measures, while important, require further actions to have a significant impact. This category includes, for example, measures related to uploading data on individual benefits to the SISO in 2013 and 2014, which, although the data have continued to be updated, significant sustainability challenges remain including the lack of rules requiring ministries to supply nominalized information. In contrast to the case of the 2008 PBL, the Bank approved technical cooperation operations that supported compliance with conditionalities under the new PBL. An operational evaluation of Mi Bono Seguro was financed (GU-T1092), together with an evaluation of processes and a plan to improve targeting (GU-T1238). However, Bank support for the implementation of these plans or recommendations has been less substantial. Under technical cooperation operation GU-T1092, resources totaling US\$54,000 were also used to finance ad hoc consultancies for MIDES (improvements to the registry beneficiaries, processes to improve transfers, and the campaign to improve child nutrition). However, this support was limited compared to the scale of the need to strengthen MIDES as the lead agency for social policy.

Coverage and geographic targeting were improved, but the social protection system continues to face major challenges. Creation of MIDES was a necessary step in formalizing the social protection system. The ministry already has a structure for coordinating social programs, processes and operating rules, though it needs to be strengthened. According to an operational evaluation of Mi Bono Seguro processes, there has been a certain stabilization in the program’s operational cycle, and this has allowed geographic targeting to

be strengthened. Structural problems remain, however, such as a lack of sociodemographic information and ongoing improvement in beneficiary data, as well as follow-up on the part of the ministries with respect to coresponsibilities. There have also been recurring delays in transfer payments, which have a direct impact on beneficiary behavior.

3. Citizen security and peaceful coexistence

Progress toward strategic objectives cannot be attributed to Bank support. The objective of strengthening the National Civil Police (PNC) was supported through a technical cooperation operation (GU-T1190) approved in 2011, which has been subject to substantial delays due to institutional and design problems. The relevance of the project was also diluted by the fact that the police reform it was supposed to support had already been designed and funded by the time the project reached eligibility. As a result, it was adjusted to support individual activities to strengthen the PNC that need to be institutionalized. Approval of a loan (GU-L1095) to support the second objective of improving the quality and results of criminal investigations is expected in late 2016. The third objective, of reducing the vulnerability of women and young people to violence and crime, was supported by technical cooperation operations GU-T1232 and GU-T1233. These were approved in 2014 and were aimed at fostering the economic independence of female victims of violence. The proposed models have not yet been implemented. A loan (GU-L1070) to support the first and third objectives was planned for 2012, but was ultimately not approved. The portfolio also includes operations that are not directly related to the objectives. The sole loan in execution (GU-0177, approved in 2007) supports several justice sector entities, mainly in the form of infrastructure. Execution of a technical cooperation project to support an electronic notification system in the Constitutional Court (GU-T1190, approved in 2012) was prolonged due to underestimation of the impact of changes in the presidency of the court each year.

Progress under the justice loan has been limited, largely due to its decentralized execution mechanism. The loan (US\$30 million) was ratified four years after its approval, while eligibility took 14 months due to delays in establishing the executing agencies and the execution model. The program has five executing agencies, which has created difficulties in the context of uneven execution capacities. In addition to technical weaknesses in the executing agencies, for example, with respect to works execution, there have been continual changes to the leadership and staff of the executing agencies, low annual budget allocations, difficulties experienced by the executing agencies in hiring staff, and the political crisis, which delayed several bidding processes. Financing has been provided for pre-investment studies and technical inspections, and a number of bidding processes are under way. Despite this, there are no concrete infrastructure outputs as of yet, and the possibility of introducing reimbursements for completed works is being analyzed. Financing has been provided for diagnostic assessments of information and management systems, as well as the procurement of software and IT equipment for the entities. The short-term challenge, however, is to achieve system interoperability. The program expires in December 2016 but has disbursed only 30%, meaning that it is unlikely that its objectives will be achieved.

B. RURAL AXIS

1. Rural productive development

The country strategy established two ambitious strategic objectives: *improving incomes for rural households* and *diversifying sources of income*. However, the diagnostic assessment and definition of the objectives were based essentially on an analysis prepared by the Environment, Rural Development, and Disaster Risk Management Division (which placed strong emphasis on the agricultural sector) and on a loan planned for 2012 (GU-L1069) that was not approved. Accordingly, only the Project to Support the Rural Economic Development Program (PDER, approved in 2006) bears a relationship to country strategy objectives. Additionally, a substantial part of the MIF's portfolio consisted of support for rural producers.

The PDER, which was designed as a multisector program, has experienced significant execution problems and was restructured. The PDER (GU-L1006, US\$30 million) was cofinanced by the World Bank (US\$30 million) and envisaged investments in production chains and the strengthening of public territorial management. The design was ambitious, consisting of three components (with eight subcomponents) and three executing agencies. Funding was reallocated under the program—mainly to infrastructure—and as a result, various components were not executed or were reduced in scope. There were also several changes in executing agencies under the program due to the closure of some institutions and problems of political interference and integrity in the selection of subprojects and beneficiaries. Management capacities have been uneven across the executing agencies, while demand on the part of rural groups was insufficient to meet eligibility criteria. Support has been provided for business and entrepreneurial strengthening plans (mostly with World Bank funds) in communities in 20 departments (90% of the beneficiary population are indigenous and 34% are women), as well as for productive infrastructure, although there is no evidence regarding the effectiveness of this. The program has been extended by almost five years and 54% of funds have been disbursed; remaining uncommitted funds will be used initially to finance transportation infrastructure in Chixoy.

MIF support—in the form of technical assistance for improvements in productivity and market access and financing under the Social Entrepreneurship Program—was broad and dispersed. Operations completed over the evaluation period benefited more than 40,000 producers (mainly indigenous and female) in areas such as tourism, agriculture, and textiles. A number of factors limited implementation, including weak management capacities in a number of counterparts; rotation among the team of MIF specialists in the country; underestimation of risks in a number of cases; and challenges in providing specialized technical assistance to rural communities (particularly in terms of finding local specialists that spoke the beneficiaries' languages and were knowledgeable about particular crops).

There is no evidence of progress toward achieving the strategic objectives. The program with the public sector was smaller than planned, and the only active loan has been subject to significant implementation difficulties. The MIF provided significant support for rural, low-income outputs. However, these were scattered and isolated, which puts their sustainability at risk. Accordingly, the MIF's participation in Guatemala would have benefited from a more defined intervention strategy and greater coordination with the public sector area of the Bank under the umbrella of comprehensive, strategic support for rural productive development.

2. Health

The Bank established three strategic objectives for rural areas: (i) *reduce under-5 chronic undernourishment*; (ii) *reduce child mortality*; and (iii) *improving maternal health*. The objectives were relevant and the implemented program was generally well aligned with these objectives. The health component of the PBL (GU-L1085) was aimed at laying the groundwork for a system of primary health care for subsequent implementation with the support of investment grants under the Mesoamerican Initiative (GU-G1001 and GU-G1002, approved in 2013 in 2015) and the Improved Access and Quality of Health and Nutrition Services Program (GU-L1022, US\$35 million) approved in 2010. The portfolio also included a loan approved in 2007 to strengthen the hospital network (GU-L1009 for US\$50 million) and 10 technical cooperation operations (4 approved prior to 2012) focused mainly on nutrition and primary health care. However, these were ad hoc and scattered in nature, and were mostly unrelated to the Bank's loan portfolio. Although most of the technical cooperation operations supported a number of concrete outputs, these were not generally used to bring about changes in government policies or programs. It could not be expected, therefore, that they would make a significant contribution to the strategic objectives.

Implementation of the portfolio was hindered by various key factors. Frequent changes of leadership and staff at all levels of the ministry slowed implementation and sometimes led to changes in project design. This also meant that capacities established at the central and local levels were lost with each change. Capacity constraints and cumbersome bureaucratic procedures also led to frequent cancellations of bidding processes that were already under way, as well as delays in implementation. Investment operations also had design issues. GU-L1009 was approved without appropriate designs, technical specifications, or adequate cost estimates for the construction of a new hospital. The status of land for new hospitals was also not ascertained. GU-L1022 was extremely complex (with four components and 10 subcomponents) in view of the capacity constraints, while the primary health care service model chosen was questionable from a sustainability perspective. Frequent changes of management and staff have made it difficult for the Bank to establish a working relationship. The Bank has shown great flexibility in an attempt to adjust to the government's shifting priorities and maintain its sector presence, though the results of this are uncertain.

The hospital network program rehabilitated 10 hospitals affected by the 2012 earthquake and constructed 1 new one, though the latter is not yet operational. Alterations to the specifications for the hospitals led to an almost fourfold increase in unit costs (from US\$8.5 million to approximately US\$30 million), limiting construction to just one hospital instead of the three planned. Construction of the hospital is almost complete after more than eight years of implementation, but cost overruns mean that the loan resources are insufficient to cover equipment and furnishings; as a result, the hospital is not yet operational. The project part-financed the rehabilitation of 10 hospitals affected by the earthquake and helped 13 hospitals to develop maintenance plans. A lack of budgetary resources has limited implementation of these plans by the hospitals and threatens the sustainability of the rehabilitation works. The hospital management component was successful in helping to develop and implement new management models in a number of hospitals, and the ministry subsequently expanded these to include other hospitals. Nonetheless, frequent changes in hospital directors and associated staff endanger the sustainability of these achievements.

Progress under the primary health care access program has been scant, while targets under the Mesoamerican Initiative have been met with delays. A central aspect of the design of operation GU-L1022 was the creation of mobile teams to deliver basic maternal and child health services in unserved areas. However, the project's ability to provide sustainable primary health care to the target population has been limited by the need to offer individual annual contracts to each team member, and by the government's decision to discontinue the mobile team model promoted by the Bank in favor of a different, less costly model. The construction of new primary health care centers has not begun, and no facility has received the planned equipment. The likelihood that development objectives will be attained has been brought into greater question by reallocations of funds, as well as a new proposal for activities that are unrelated to the program (staff for the Mesoamerican Initiative, hospital equipment, national drug supplies). As part of the framework for the first grant under the Mesoamerican Initiative, the government had committed to ensure the availability of equipment and medical supplies in health centers in 17 municipios. However, due to complex design, bureaucratic procedures, and delays in the availability of budgetary funding, the indicators were not met within the agreed time period, leading to cancellation of the performance-based tranche and part of the investment grant. The targets were met subsequently, leading to approval of the second grant.

The health component of the PBL helped to lay the foundations for strengthening the system of primary health care service delivery, though its results will depend on the government's ongoing commitment to implementing the new regulations and guidelines. In general, the components supported a coherent set of processes and policy measures. There was a logical progression in the measures between the different tranches, with the second tranche focusing on the initial implementation or piloting of the technical guidelines and regulations that the Ministry of Public Health and Social Welfare had approved under the first tranche. Nonetheless, given the limited amount of time between the first and second tranches, the scope of implementation

was intentionally limited (and was more limited still in practice). Unless there is ongoing follow-up and government commitment to continue with implementation, it is unlikely that the measures will have a lasting impact.

Chronic malnutrition and maternal and child mortality have declined, but levels remain high and it is unlikely that the Bank has contributed significantly. Progress has been made toward the indicators in the country strategy, but the baselines date from 2009, before the country strategy period. Limited achievements under investment operations and the scattered and opportunistic nature of technical cooperation operations make it unlikely that Bank operations have contributed significantly to these improvements. The PBL supported the adoption of a series of technical manuals and regulatory documents that provide the basis for a more efficient primary care system, although these measures will require monitoring and effective implementation in order to have an impact on outcomes in nutrition and maternal and child health.

C. DIALOGUE AREAS

1. Education

The portfolio has focused on school infrastructure, the quality of education, and school management. In 2008, the Bank approved the My School is Making Progress program (GU-01023, US\$150 million). There have been significant changes to execution arrangements for the program, including modification of the financing instrument and targeting criteria, reallocations between components, and several changes in the executing agencies for the infrastructure component. The component currently has three executing agencies. As of July 2016, 60% of the loan had been disbursed, causing it to be extended until April 2018. In 2015, the Bank approved a new loan with a similar structure (GU-L1087, US\$150 million), but this has not yet been ratified by Congress. The PBL in the social area (GU-L1085) also contained education measures, including the creation of a grant fund for teachers that is expected to be financed using Bank resources. Other measures (e.g. joining the Programme for International Student Assessment) were of lesser depth.

In infrastructure, progress was made in school repairs, but there were substantial delays to the construction of new classrooms and furnishings. As of 2015, 35 schools affected by the 2012 earthquake had been repaired with execution outside the National Public Investment System, with a further 142 medium-level repairs and 3,346 minor repairs. An evaluation financed under a technical cooperation project (GU-T1205) indicated that conducting minor repairs through parents' associations has been an effective mechanism. Progress in building classrooms has been affected by a lack of budgetary funding and lands with clear title, as well as uneven capacities between executing agencies. As of 2015, 47 pre-primary schools (target: 347) and 121 primary schools (target: 421) had been built.

In terms of the quality of education and school management, the main progress has been seen in book purchases and teacher training, although this has not been reflected in quality improvements. As resources were lacking to train all primary school teachers, a training

alternative was used involving Ministry of Education authorities at the departmental level. As of 2015, 3,346 teachers had been trained (target: 11,000) and 4.5 million books had been delivered to 27,800 establishments (using a standardized process to ensure their relevance). An evaluation supported under technical cooperation project GU-T1005 confirmed that the books are in the classrooms and are generally being used, but there is no evidence regarding physical deterioration or the impact on national reading test results. Teaching evaluations were also supported, though the challenge is to incorporate the results into the educational model and to monitor the process on an ongoing basis.

2. Energy

The Bank's portfolio has focused on rural electrification. Since 2008, the Bank has been providing support for the Rural Electrification Program (PER) with a multiphase program (GU-L1018, GU-L1084) for US\$110 million executed by the Instituto Nacional de Electrificación [National Electrification Institute] (INDE). In 2014 and 2015, the Bank also approved two technical cooperation operations (US\$530,000) with the Ministry of Energy and Mines to improve management of the ministry (GU-T1203) and hydrocarbons management (GU-T1235). However, both operations have been slow to get off the ground. The contracts for the IIC loans (US\$13 million) approved in 2013 for hydroelectric power plants have not yet been signed as a result of significant social conflicts affecting construction. These have prompted greater coordination between the Bank and the IIC.²⁵

The first phase of the program to support the PER executed quickly, due mainly to its executing mechanism. The program had its last disbursement in October 2015, after being extended for a couple of months due to delays in a project involving off-grid systems. The executing agency was located in INDE's General Management Department, and although there was turnover among the leadership and staff, the PER remained an institutional priority and the executing agency had autonomy, thus facilitating program management. Nonetheless, the key factor accounting for this performance was the use of a trust fund for the main component consisting of electricity connection to grids. Under this arrangement, loan funds were used to reimburse payments issued by the trust fund for advanced or completed works. Contracting of works was also expeditious, as it was not subject to national procurement law (only the procedures set out in the trust fund contract), and the distribution companies themselves performed the construction work to expand the network. The program was accompanied by a technical cooperation project (GU-T1120) that supported program launch and execution. The main output of this project was the Rural Electrification Master Plan, which guides investment in rural electrification.

Significant progress was made in relation to electricity service coverage, although the sustainability of investments and the implementation of off-grid systems are important challenges. In total, 455 communities benefited (200,000 inhabitants), located in 108 municipios in 17 of the country's departments. The program surpassed its targets, connecting 36,577 homes to the network, installing 188 km of transmission lines, and building seven 69kV substations. It also connected a further 3,380 homes in remote

areas (target: 5,000) under two pilot projects. The implementation of off-grid systems was affected by a lack of demonstration projects and limited private sector interest. Given that these projects did not fall under the trust fund, an execution mechanism had to be established; this was redesigned at the end of 2013. Sustainability challenges relate to the communities' limited ability to pay and to assume responsibility for operation and maintenance, threatening the continuity and quality of service. A number of works also faced opposition from communities, and the social management of projects therefore needs to be deepened. The Rural Electrification Master Plan needs to be updated due to demographic growth and the emergence of new communities, as well as to identify the current most cost-effective solutions. The Bank approved a second phase in 2014 that has not yet been ratified since the execution mechanism has not been defined. Continued use of a trust fund was planned, but the first phase expired in 2015. This discussion occurs against the background of a debate regarding trust funds, given the increase in their use and weak controls in some cases.

D. OTHER AREAS OF SUPPORT

1. Water, sanitation, and solid waste

The portfolio is made up of operations approved prior to 2012. At the beginning of 2012, eighty percent of funds remained undisbursed under two operations for rural water and sanitation systems (GU-0150, GU-L1039/GU-X1005) and another supporting the environmental recovery of the Lake Amatitlán watershed (GU0066). In addition, during the government handover at the end of 2011, a technical cooperation agreement (GU-T1177) was approved to prepare a strategic plan for solid waste; however, it was almost fully canceled after a prolonged execution period and differences between the Ministry of Environment and Natural Resources and the consulting firm regarding the quality of outputs.

Substantial amounts of resources were canceled under the program for the Lake Amatitlán watershed. A number of outputs were produced, but sustainability is low and there is no evidence that environmental deterioration has been reversed. The program, approved in 2005 for US\$23.8 million, was extended by more than four years, due to delays in contracting international consulting services and establishing advisory teams to evaluate final designs for works, low participation of the municipios involved, government intrusion, and management weaknesses at the Autoridad para el Manejo Sustentable de la Cuenca del Lago de Amatitlán [Authority for the Sustainable Management of the Lake Amatitlán Watershed] (AMSA), mainly with respect to managing complex works. Problems were experienced in the construction of a new landfill—the main investment under the program—due to the technical and environmental infeasibility of the land under consideration at the time the loan was approved. In 2010, a temporary solution was agreed involving the horizontal expansion of the existing landfill, but delays to studies and differences between the IDB and the AMSA regarding technical solutions and the bidding process led to the cancellation of US\$8 million. The integrated management plan for the watershed was delayed, and the investment plan contained in it has received limited

financing. The plan was also to adapt and close the existing landfill given its level of saturation; however, as construction of a new one was not possible, the AMSA decided to expand it and extend its operations on a temporary basis. It continues to operate at present, and the number of illegal dumps has increased. Financing was also provided for a reform proposal in the area of solid waste collection and disposal, although the municipios have not shown interest in approving it. Works financed to stabilize the banks of the Villalobos river have helped to reduce erosion and protect infrastructure, but targets related to sediment input due to climate events have not been achieved. A further US\$1.3 million were reallocated to emergency projects. Sustainability is affected by weak AMSA coordination with the municipios, as well as a lack of a water resources policy and management and regulatory hurdles that reduce the AMSA's ability to perform regulatory and control functions.

Under the rural water and sanitation program, a change of approach and execution arrangements failed to make allowance for the institutional capacities necessary for implementation. Under the program (GU0150, approved in 2003 for US\$50 million), resources were to be provided through a trust fund that would allow communities to execute their own projects, with repayments used to finance new projects. The program included funds for promotion and technical assistance to the communities using NGOs or private enterprises. Given the weak management capacity of the executing agency (INFOM), a management firm and supporting consultancies were to be contracted. The loan attained eligibility five years after it was approved, following contractual modifications at the government's request that included a change in the financing mechanism (away from reimbursements for community projects to direct subsidies via investment) and the transfer of responsibilities for design and work contracts away from the communities to INFOM. The planned management company was eliminated and INFOM took over responsibility for program coordination, as well as the supervision and social management of the projects.

Improvements in coverage were less than expected, with substantial challenges remaining with respect to institutions and sustainability of the investments. In total, 110,367 people benefited from drinking water (target: 340,623) and 57,630 from basic sanitation (target: 96,152). Fewer projects were executed due to incomplete works and failures to undertake bidding processes; these were, in turn, the result of a series of problems that included weaknesses in pre-investment studies, the limited involvement of communities and municipios in the project cycle, contractor weaknesses, cost overruns, and weak social and environmental management, as well as political interference in some interventions and significant issues of transparency that led to the involvement of the IDB's Office of Institutional Integrity. Sustainability was affected by the communities' limited payment capacity, a lack of mechanisms for setting rates and recovering costs, scant supervision, and weak governance and fragmented responsibilities in the sector. Of the consultancies planned for INFOM, only those related to technical standards for aqueducts and rural sanitation were carried out. After several extensions, US\$14.7 million of program funds were cancelled. These problems affected the launch of a new operation with INFOM (GU-L1039/GU X1005, US\$100 million); this was approved in 2009 and has disbursed 12%. UNOPS-UNDP has been engaged to support procurement and institution-strengthening, and the Bank is working to strengthen the executing agency's autonomy.

2. Environment and natural disasters

The portfolio encompasses a range of areas. The biodiversity and conservation portfolio includes one operation to support conservation of the Maya Biosphere Reserve (GU-L1002/GU-X1001, approved in 2006 for US\$33.6 million), and another approved in 2009 for a registry of protected areas (GU-L1014, US\$22 million). In climate change, the portfolio consists of 10 technical cooperation operations (8 related to a PBL approved in 2010). The technical cooperation operations were mainly used to support fulfillment of conditionalities (US\$4 million). In general, outputs have varied in relevance and not all of them have managed to generate interest from counterparts. Two technical cooperation agreements (US\$400,000) are supporting climate change groups in the Ministry of Finance and the Presidential Planning and Programming Secretariat with the new responsibilities assigned to them under the Climate Change Law. Progress has been limited, however. The Bank also approved technical cooperation operations for emergencies, mainly the special program for emergencies in case of natural disasters. This program has experienced difficulties in execution and the documentation of eligible expenditures. More recently, the Bank has been supporting preparation of an REDD+ strategy through technical cooperation operations totaling US\$4 million (GU-T1194, GU-T1257), implementation of which is getting under way.

The program for results-based management has been affected by the complexity of its design, and although several projects have materialized, these have been uncoordinated and sustainability is a challenge. The program has so far been extended by almost three years, and as of June 2016 had disbursed 88% of funds. Its design encompassed different areas (tourism, culture, heritage, water bodies, biodiversity, conservation) and required the participation of five institutions coordinated by an execution unit at the Ministry of Environment and Natural Resources (MARN). Additional to the changes of authorities at MARN and the execution unit are the inherent difficulties of working in the Petén region (which is characterized by weak institutions and low State presence), and rising levels of violence and insecurity. In line with the program design, most of the resources have been for projects proposed by the communities. The main investment was the construction of a water treatment plant, expansion of which is currently under way and is expected to benefit 30,000 people. Difficulties and irregularities were experienced in the bidding process, leading to cancellation of the first process. Other outputs are a joint operations center and equipment for forest control and surveillance; updating of the Maya Biosphere Reserve master plan; the development of plans for commercial forestry holdings; a visitors center; and construction of a Mundo Maya Museum. (The plan was for the latter to be accompanied by tourism development activities, but these did not ultimately occur.) The executing agency lacks records for many of the projects financed, highlighting the institutional weaknesses that the agency has experienced. Low State presence, as well as weaknesses in the surveillance and control of protected areas, could also affect results.

In the case of the program to support a register of protected areas, there have been different phases of execution, although substantial progress has been made. The program consisted of four targeted components, to be executed by the Registro de Información Catastral

[Cadastral Information Registry] (RIC). Execution proceeded quickly in the first year, but changes to the RIC leadership over the 2013–2015 period affected the priority that the institution placed upon the project, leading to delays. The former RIC director was reappointed in October 2015, and execution got under way once more. The program expires at the end of 2017, and 82% of funds have been disbursed. Under the main component, aimed at strengthening legal certainty in protected areas (75%), the fastest progress has been seen with respect to demarcation proposals for protected areas (76%) and the number of km² of protected areas registered (52.8%). The demarcations that remain are the most complex ones, as they are located in the most conflictive areas and the fragmentation of landholdings raises the costs and length of time required for registration. Moreover, until 2015 it took a long time to secure the approval of the Consejo Nacional de Áreas Protegidas [National Protected Areas Council] (CONAP) to conduct cadastres. Sustainability is linked to the ongoing updating of the registry by the municipios, but the latter often lack the necessary resources and interest.

3. Financial system and competitiveness

The IIC's work with financial intermediaries sought to support the SME portfolio, although it cannot be concluded that the resources reached the segments in most need. Reports prepared by the intermediaries show that a total of 26,147 SMEs benefited (according to the local definition of an SME). In addition to the fungibility of money and the lack of established targets for percentages of the portfolio, the IIC's definition of an SME is broader than the local one, and this has created an incentive to finance large companies also. This situation has been reflected in defaults on a number of loans and an increase in loan size. Due to the amounts involved, the local definition allows a loan to a large company to be categorized as small business lending, making it difficult to monitor targets. These operations have also served as a guarantee amid the world economic slowdown and risk reduction that has led a number of banks to exit the Central American market. From the clients' perspective, the greatest difficulties relate to the use of international regulations, which complicate legal review.

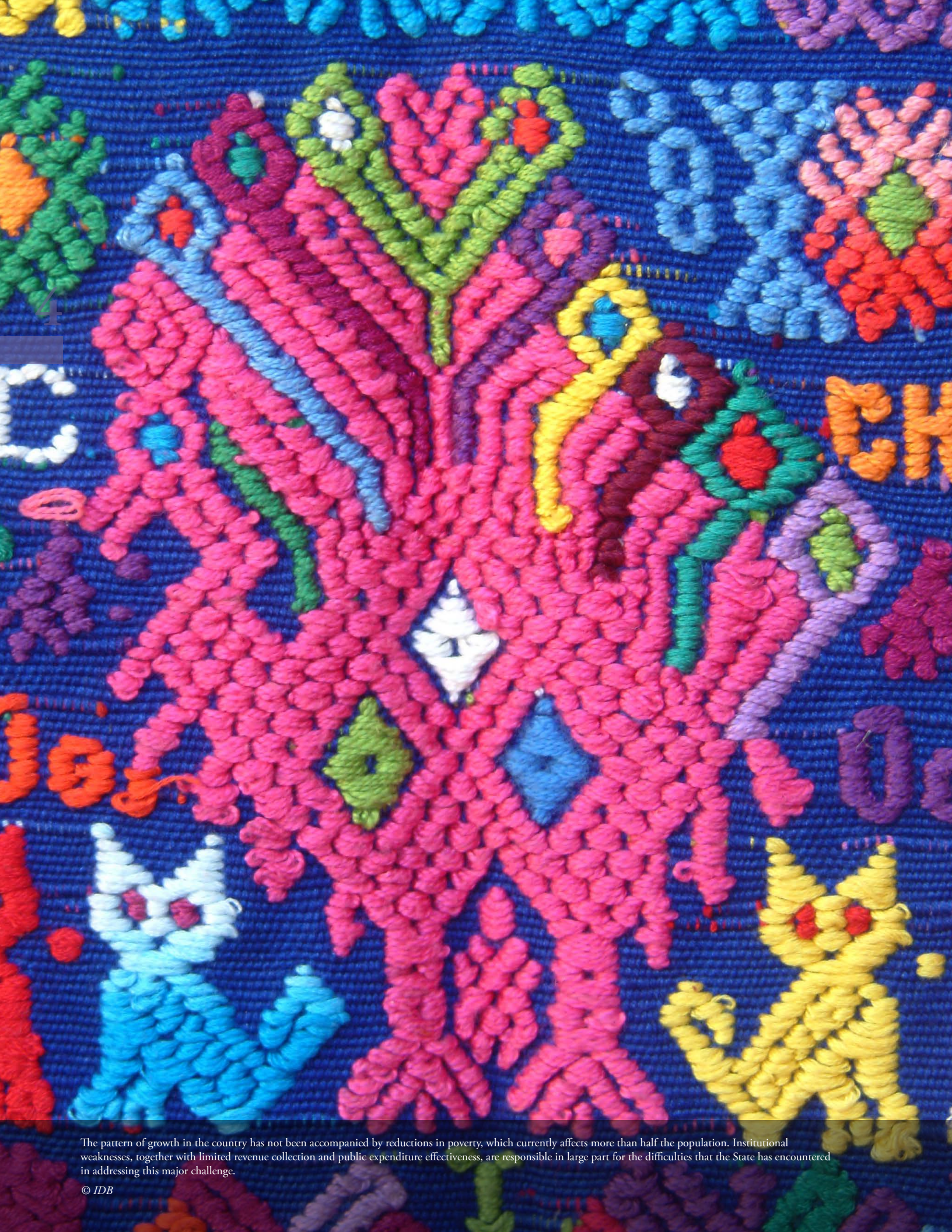
The Trade Finance Facilitation Program (TFFP), in addition to its financial importance to the IIC, supported foreign trade operations totaling US\$492 million. The TFFP was efficient for the IIC in terms of disbursements, with the growing use of loans as a substitute for guarantees. Four of the banks supported by the IIC received foreign trade financing totaling US\$230 million from international banks, of which 99% was guaranteed by the TFFP. The IIC also directly financed US\$196 million and leveraged a further US\$66 million.

The results of support for access to finance among MSMEs fell short of expectations. The portfolio also includes a series of technical cooperation operations in this field that were approved prior to 2012. However, shifts in the country's priorities meant that a second-tier development agency for MSMEs was never designed (GU-T1168), while there was little success in formalizing these enterprises or in registering movable

collateral to support access to finance (GU-T1113). Nonetheless, support for regulating microfinance institutions did succeed in enhancing the capacities of the Banking Superintendency.

The Program to Support Strategic Investments and Productive Transformation encompassed a series of disconnected interventions, and progress to date has been scant. The loan (GU0163, US\$29 million) was approved in 2006 as a citizen security project, but was reformulated in 2009 in response to a government request. It reached eligibility in 2013. The program envisioned interventions in a variety of areas: the investment and business climates; structuring and promotion of strategic investments; business development and production chains; the institutional framework for competitiveness; and strengthening of the executing agency (PRONACOM). The program expires in February 2017 but has disbursed only 16% of funds, due mainly to a lack of definition regarding outputs and the absence of a strategy for executing the main component (business development and production chains, for which a strategy was recently approved in 2016). A lack of budgetary allocations has been a recurring problem. PRONACOM's capacity for planning and managing projects is low and there has been high turnover among its staff. With respect to the investment and business climates, two electronic platforms were financed to streamline bureaucratic procedures. Pre-feasibility studies have also been contracted for infrastructure projects, although the bidding processes have not yet begun. In the area of regional development, regional competitiveness consultancies and spatial development plans were completed, though uneven capacities at the regional level have affected implementation.

Design of the Trade and Integration Program was ambitious, and the main results are in MSME internationalization; however, execution has not been free of difficulty. The program (GU-L1037, approved in 2008 for US\$20 million) had five components covering almost all functions of the Ministry of the Economy (international agreements; export promotion; attracting investment; MSMEs; technological modernization). There has been high turnover among the staff of the executing agency, which has lacked the capacity to coordinate the three vice ministries involved—a situation that was complicated by the change in government in 2016. Delays were also created by regulatory uncertainty regarding the contracting process and a lack of guidelines governing the allocation of a number of benefits. The program was extended by three years, and 90% of funds have been disbursed. The program focused on SMEs, but the majority operate in the informal sector, and there was less interest than expected from SMEs operating in the formal sector that meet the cofinancing requirements. However, most of them operated informally and no technical assistance was included to allow them to benefit under the program. The actions to strengthen entrepreneurial activity benefited 244 MSME (14 departments), generating business worth US\$8.1 million, as well as additional local sales of US\$1.4 million and 630 new jobs. Five promotion centers were created, allowing more than 5,000 people to be trained. The other components have financed various ad hoc outputs, particularly support for the negotiation of trade agreements under way, and principally consulting services to support the day-to-day management at the Ministry of the Economy. There is no evidence yet regarding their effectiveness.



The pattern of growth in the country has not been accompanied by reductions in poverty, which currently affects more than half the population. Institutional weaknesses, together with limited revenue collection and public expenditure effectiveness, are responsible in large part for the difficulties that the State has encountered in addressing this major challenge.

4 Conclusions and Recommendations

The country strategy included a number of possible areas for cooperation, with strong emphasis on rural issues. Strategic objectives were relevant, but the expected outcomes were ambitious in many cases given the difficulties that the Bank has traditionally faced in implementing operations in the country. The program with the public sector was composed mainly of PBLs and a significant portfolio of technical cooperation operations, as well as isolated investment loans in several sectors approved prior to 2012 with lengthy execution periods.

In addition to their financial importance in a context of high budgetary uncertainty, the PBLs included policy conditions that were mostly of medium depth. Although these represent important steps, they require government commitment for their implementation, as well as other supporting actions to have a significant impact. Investment loans have continued to exhibit significant execution problems and are the portfolio with the greatest number of extensions at the Bank. Despite these difficulties, there have been no major project cancellations, and the Bank has shown a high degree of flexibility in adjusting its operations to changing government requirements. Many of these changes, however, have affected both the implementation of operations and the attainment of their development objectives. Although the country received significant amounts of technical cooperation funding, most was not used to support the loan portfolio; instead, it was often used in a more scattered and opportunistic manner without a clear link to strategic objectives or intentions. The IIC performed an active role, but relied mainly on financial intermediaries to channel support for SMEs and foreign trade operations. Nevertheless, the SME support strategy has had limitations.

Despite advances in a number of areas, progress toward achieving strategic objectives was generally limited. The main reason for this lies in the fact that several planned loans failed to materialize, while there were also delays and problems in executing active loans. Moreover, although important outputs have been completed, sustainability challenges remain owing to factors such as a lack of funding, high turnover among civil servants, limited engagement of key stakeholders, and weak governance in some sectors. In this context, the territorial approach envisaged in the strategy was also more limited than expected.

The pattern of growth in the country has not been accompanied by reductions in poverty, which currently affects more than half the population. Institutional weaknesses, together with limited revenue collection and public expenditure effectiveness, are responsible in large part for the difficulties that the State has encountered in addressing this major challenge. Against this backdrop, the Bank has not succeeded in providing the kind of effective support that would have helped to address the structural problems of poverty. This has been reflected in implementation problems and limited results under the operations, and the Bank therefore needs to redefine its strategy for support to the country with the objective of promoting more significant and lasting changes and outcomes.

Based on the findings of this evaluation, OVE makes the following recommendations:

1. In dialogue with the government and financial support, prioritize the structural problems of governance that limit the State's effectiveness. In particular, the State's ability to address the country's major challenges, including the delivery of basic services to a substantial share of the population, is limited by low capacity for revenue collection, weak public expenditure efficiency and effectiveness, and problems of transparency.
2. Restructure and reduce the size of the current portfolio. OVE reiterates the recommendation from the previous CPE, to adjust the size of the portfolio to the country's institutional capacity. In dialogue with the government, operations with significant problems, high transaction costs for the Bank and the country, and those regarded as nonpriority should be canceled. The Bank should also limit extensions to its operations, particularly by not extending projects that have made little progress, and should set specific criteria for the maximum number and time for extensions of the current portfolio.
3. Reorient the use of lending instruments toward achieving results. Given the substantial structural problems in implementation and limited progress in operations, the Bank should explore new results-based mechanisms focused

on the implementation of reforms and measures begun with Bank support. The Bank should also play an important role supporting the implementation of these measures and achievement of results, so that they have a more lasting impact.

- a. Structure the final tranches of PBLs with policy conditions (in the policy matrix) focused on achieving results (rather than actions focused on processes or policies) that encourage the implementation of reforms and measures begun in the early tranches of the PBLs.
 - b. Explore within the Bank the possibility of piloting new results-based approaches or instruments.
4. Only approve operations with simple designs and more thorough analyses, to help minimize design problems in the current portfolio. If the Bank decides to approve new investment operations, the designs should involve no more than one executing agency, a small number of components with clearly defined outputs and technical specifications. The Bank should also deepen its analysis of both institutional capacities for project management and the legal and technical viability of its operations, including certainty that suitable land is available in the case of infrastructure projects. Additionally, the Bank, in dialogue with the government, should incorporate conditions to ensure greater stability of executing agency staff.
5. Use technical cooperation principally to support the preparation and execution of loan operations. Given the significant implementation problems experienced, approval of technical cooperation operations to support loans should be the priority. If technical cooperation operations are approved to support other priority initiatives of the government and the Bank, these approvals should be more limited and contained, and directly linked to the established strategic objectives and lines of support.
6. Redefine the IDB Group's strategy for private sector support in the country to focus on the main constraints to private sector development, as identified through a specific diagnostic assessment for the country. In the event that SME access to finance is identified as one of these priority constraints, the IDB Group should restructure its current strategy of support through financial intermediaries to target the segments most in need and promote greater competition in the financial system through a better balance of intermediaries supported.

- ¹ Guatemala's GDP stood at US\$58.8 billion in 2014. GDP composition by economic activity is relatively diversified and has remained stable over time. Nonetheless, the financial sector (5.8% of GDP in 2015) has grown at the fastest rate: 9.7% per year on average in 2005-2015 and 11.2% on average in 2012-2015.
- ² Guatemala ranks 128th on the Human Development Index, the second lowest in Latin America and the Caribbean.
- ³ In contrast, the lowest rate of growth was seen in the gross fixed capital formation component (14.6% of GDP): 2.4% in 2005-2015 and 3.8% in 2012-2015.
- ⁴ As a percentage of GDP, both revenue (11.7%) and expenditure (13.9%) have remained relatively stable over the last decade (Figure 9, Annex I).
- ⁵ From 1970 to 2016, Guatemala was hit by 80 major disasters that affected 14 million people and created economic losses totaling almost US\$4.5 billion (EM-DAT International Disaster Database). According to the 2014 World Risk Report, Guatemala is the eighth most exposed country in the world and the fourth most at risk of suffering disasters caused by adverse natural events.
- ⁶ The poverty line was 4,319 quetzales per person per year in 2006, rising to 10,218 quetzales in 2014. Major changes in the methodology for the 2014 National Survey of Living Conditions (ENCOVI) mean that this survey can only be compared with the 2006 version, and not with the 2011 version.
- ⁷ Most recent National Maternal and Child Health Survey (ENSMI), 2013-2014.
- ⁸ The World Bank's Enterprise Survey (2010) identified crime, theft, and disorder as the leading obstacle (20.8%) to business development. A World Bank study estimated losses due to violence and insecurity at 7.7% of GDP in 2011.
- ⁹ Guatemala ranks 95th out of a total of 102 countries in terms of the effectiveness of its justice system (source: World Justice Project 2015)
- ¹⁰ Since the Constitution was approved in 1985, no party has won the presidency on more than one occasion. Parties are short-lived (more than 50 have been deregistered since 1985), and the ease with which politicians change party affiliation creates constant shifts in the political makeup of Congress, hindering the legislative agenda. (In every year for the last decade, more than 25% of representatives have switched parties).
- ¹¹ The CICIG is an independent, international body sponsored by the United Nations. It was established in 2007 at the request of the Government of Guatemala, with the aim of investigating and supporting the criminal prosecution and disbanding of criminal networks.
- ¹² Five banks account for 82% of total banking system assets. Source: Report of the Banking Superintendency to the Monetary Board, 31 March 2016.
- ¹³ The program for 2012 and 2013 included six loans, five of which were directly related to country strategy areas and objectives. In addition, months before the strategy was approved, a PBL had been approved in the fiscal area that included policy measures in the three areas with objectives.
- ¹⁴ According to the country strategy, the Bank would "identify the interventions in the rural development area and determine a coordinated roadmap for the array of actions to overcome the challenges identified, bearing in mind the synergies and potential economies of conglomeration (inter- and intraterritorial)."
- ¹⁵ The Fiscal Consolidation Program for Guatemala (GU-L1064) was divided into a multitranche PBL (US\$234 million) and a reimbursable technical cooperation operation (US\$3.2 million).
- ¹⁶ Sovereign-guaranteed (category A) loan pipeline as of October 2016, consisting of one PBL (US\$250 million) and one investment loan (US\$60 million).

- ¹⁷ Since 2011 the Bank had been preparing a municipal investment loan, but in May 2012 the incoming government requested that this be changed to a PBL to support fiscal consolidation, with one of the components containing conditionalities in the municipal area. Support for the social safety net through a PBL in the social area had been envisaged as an investment loan in the 2012 programming cycle. At the government's request, the Bank opted to support reforms in a difficult fiscal context.
- ¹⁸ Consisting of one PBL supporting the climate change agenda (with an undisbursed balance of US\$100 million) and another 17 investment operations with an undisbursed balance of US\$474 million (LMS50).
- ¹⁹ Includes Structured and Corporate Financing Department (SCF) operations (US\$231 million) and Opportunities for the Majority Sector (OMJ) operations (US\$3 million) approved between 2012 and 2015, prior to the merge-out of the Bank's private sector windows with the IIC.
- ²⁰ In June 2012, the country regained access to international financing. In the period from June 2012 to May 2016, the country issued three bonds for a total of US\$2.1 billion, with maturities of between 10 and 15 years and interest rates of 4.5% to 5.75%. The last issue had been in October 2004 (US\$330 million).
- ²¹ The two investment loans approved in 2014 and 2015 have not been ratified by Congress. Those approved during the previous evaluation period took 19.9 months on average to be signed.
- ²² Measures include ceilings on salaries in executing agencies; a bar on some execution mechanisms (e.g. NGOs); infrastructure execution on State lands only; the administration of external funding by permanent government employees only (which has necessitated the creation of new positions in institutions, a process that has been slow). These have reduced the autonomy of executing agencies.
- ²³ The involvement of the CABEI and other lenders is planned in the case of IIC loans supporting hydroelectric dams, but no contracts have yet been signed.
- ²⁴ The program for 2013 envisaged the approval of a program (GU-L1076, US\$83 million) directly related to the strategic sector objectives included in the strategy.
- ²⁵ Several Bank divisions are working to add social measures, including, for example, the provision of electricity services to communities in the area around the project.