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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A PROPOSED

DEVELOPMENT POLICY FINANCING

IN THE AMOUNT OF US\$[250] MILLION

TO

THE REPUBLIC OF GUATEMALA

FOR THE

FIRST PROGRAMMATIC IMPROVED GOVERNANCE OF PUBLIC RESOURCES AND
NUTRITION
DEVELOPMENT POLICY FINANCING

October 17, 2016

Macroeconomics and Fiscal Management Global Practice
Central America Country Management Unit
Latin America and the Caribbean Region

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**REPUBLIC OF GUATEMALA
GOVERNMENT FISCAL YEAR**

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange rate effective as of October 17, 2016)

Currency Unit: Guatemalan quetzal (GTQ)

USD 1.00=GTQ7.48

ABBREVIATIONS AND ACRONYMS

AML/CFT	Anti-Money Laundering/Counter Terrorism Financing
CCT	Conditional Cash Transfers
CICIG	International Commission against Impunity in Guatemala
CONASAN	National Council of Food Security and Nutrition (<i>Consejo Nacional de Seguridad Alimentaria y Nutricional</i>)
CPE	Contractors and State Suppliers (<i>Contratistas Proveedores del Estado</i>)
CPF	Country Partnership Framework
DPF	Development Policy Financing
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IGSS	Guatemalan Social Security Institute
IMF	International Monetary Fund
IVE	Financial Intelligence Unit
LAC	Latin America and the Caribbean
MIDES	Ministry of Social Development (<i>Ministerio de Desarrollo Social</i>)
MSPAS	Ministry of Public Health and Social Assistance (<i>Ministerio de Salud Pública y Asistencia Social</i>)
PEC	Extension of Coverage Program
SAT	Tax Administration Superintendence (<i>Superintendencia de Administración Tributaria</i>)
SCD	Systematic Country Diagnostic
SEDLAC	Socio-Economic Database for Latin America and the Caribbean
SIMIS	Inclusive Health Model Information System
U.S.	United States
VAT	Value-Added Tax
TRIBUTA	Administrative Tax Appeal Tribunal

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**REPUBLIC OF GUATEMALA
FIRST PROGRAMMATIC IMPROVED GOVERNANCE OF PUBLIC RESOURCES
AND NUTRITION
DEVELOPMENT POLICY FINANCING**

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**SUMMARY OF PROPOSED FINANCING AND PROGRAM
REPUBLIC OF GUATEMALA
FIRST PROGRAMMATIC IMPROVED GOVERNANCE OF PUBLIC RESOURCES
AND NUTRITION
DEVELOPMENT POLICY FINANCING OPERATION**

Borrower	Republic of Guatemala
Implementation Agency	Ministry of Public Finance
Financing Data	IBRD Loan Amount: US\$250 million Terms: IBRD fixed spread loan for US\$ 250 million, with 20 year of maturity, including 7 years of grace period.
Operation Type	First in a programmatic series of two Development Policy Financing Operations. Single Tranche Operation.
Pillars of the Operation And Program Development Objective(s)	The Program Development Objective is to support the Government's efforts to: (i) enhance the policy and institutional framework to address primary health care deficiencies and chronic malnutrition; and (ii) strengthen the regulatory and institutional framework to improve governance of public resources and accountability.
Result Indicators	<p><i>Pillar 1: Enhancing the policy and institutional framework to address primary health care deficiencies and chronic malnutrition</i></p> <ul style="list-style-type: none"> • Percent of children 12 months old in the areas prioritized by the National Strategy to Reduce Chronic Malnutrition receiving the complete vaccination scheme required for their age. (Baseline: 74; Target: 80) • The cost of the essential package of primary health care medicines is reduced. (Baseline: Q397.07; Target: 5 percent lower) • Coverage of the health system for growth monitoring and promotion for children under 24 months old in the areas prioritized by the National Strategy to Reduce Chronic Malnutrition. (Baseline: 10 percent; Target: 30 percent) • Percent of 0-2 children in priority municipalities that complete the full cycle of nutrition verification (Baseline: 0; Target: 50) • Number of on-time transfers paid in a year to recipients of the health transfer (Bono de Salud) in areas prioritized by the National Strategy to Reduce Chronic Malnutrition (Baseline: 1; Target: 4) <p><i>Pillar 2: Strengthening the regulatory and institutional framework to improve governance of public resources and accountability</i></p> <ul style="list-style-type: none"> • Estimated VAT non-compliance level (as a share of potential VAT revenues) is reduced (Baseline: 34.2 percent; Target: 29 percent of potential VAT revenues) • Share of public procurement executed through competitive processes in total value of executed public procurement (Baseline: 36 percent; Target: 52 percent)

	<ul style="list-style-type: none"> • Percent of public employees of the Executive who are paid through the unified payroll system (Guate nóminas) with updated and verified profiles and certified identity (Baseline: 0; Target: 95 percent) • Percent of financial entities (banks, finance companies and offshore banks) that include in the compliance manual their specific ML/TF risks and assessment as well as measures for their monitoring, management and mitigation (Baseline: 0; Target: 50 percent) • Percent of financial entities (banks, finance companies and offshore banks) for which the Financial Intelligence Unit IVE checks compliance with the regulation on administration of risks and enhanced due diligence measures for CPEs (Baseline: 0; Target: 82 percent) • Number of Prosecutor's Offices specialized in handling corruption cases (agencias de la fiscalía especializada contra la corrupción) created (Baseline: 1; Target: 4)
Overall Risk Rating	Substantial
Climate and disaster risks	Are there short and long term climate and disaster risks relevant to the operation (as identified as part of the SORT environmental and social risk rating)? Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>
Operation ID	P160667

**IBRD PROGRAM DOCUMENT FOR A
PROPOSED FIRST PROGRAMMATIC IMPROVED GOVERNANCE OF PUBLIC
RESOURCES AND NUTRITION
DEVELOPMENT POLICY FINANCING OPERATION
TO THE REPUBLIC OF GUATEMALA**

1 INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Development Policy Financing (DPF) series supports the Government of Guatemala in strengthening the policy and institutional framework to reduce chronic malnutrition, improve primary health care and social programs, and enhance the governance of public resources and accountability.** The Systematic Country Diagnostic (SCD), *Guatemala: Building Bridges in Guatemala*, identifies the need to tackle key developmental challenges to reduce poverty and ensure inclusive growth. Two issues emerged as critical in this context: the high rates of chronic malnutrition and the limited fiscal resources to provide adequate public services. Scarcity of resources is exacerbated by weak governance and accountability in managing them. Addressing these issues is at the core of the new Country Partnership Framework (CPF). This DPF series is the policy anchor and lever of the CPF, and is part of a broader package of lending and analytical instruments to support the country's reforms on chronic malnutrition and governance of public resources. It supports policy and institutional actions that complement two key investment projects, namely the *Creceer Sano* Health and Nutrition Project that will finance the implementation of the malnutrition strategy, and the Transparency and Efficiency in Tax Administration Project that will finance the revamping of the Tax Administration Superintendence (SAT). The DPF amount is US\$250 million.

2. **The current country context presents an opportunity to tackle these long-standing development challenges.** Following a political and institutional crisis in 2015, the newly elected Government is starting to address these deep-rooted development challenges. The crisis was triggered by the uncovering of a corruption scheme that permeated the SAT and the highest political levels. A massive social uprising resulted in the resignation of the country's President and demand to strengthen governance. A new administration took office in January 2016, with a strong mandate to fight corruption and address social shortcomings. The key priorities of the new administration are to improve social outcomes, with a particular emphasis on reducing malnutrition rates, strengthen governance and improve accountability, among others.

3. **Improving basic public services and the effectiveness of social assistance programs, particularly to reduce malnutrition and improve primary health care, is an urgent priority.** In line with the commitment to improve social outcomes, more than 50 percent of the budget increase in the 2017 Budget proposal is being allocated to health and malnutrition. Currently, social outcomes are very low for the country's level of income: about half of all children (47 percent) are stunted, with particular incidence in the lowest quintile (66 percent) and among indigenous children (61 percent), and only one in two children (12 to 23 months of age) in the lowest income quintile received all the required vaccinations. Basic social services have received limited funding and lack a basic policy and institutional framework for delivery. This is particularly acute in the case of health care. Similarly, social assistance programs fund poor households meagerly and on an ad-hoc basis.

4. **Guatemala's poor social outcomes are partly explained by its limited fiscal resources, and governance weaknesses and inefficiencies in their use.** After reaching 11 percent of GDP in 2013, the tax-to-GDP ratio fell to 10.2 percent of GDP by 2015. This is an extremely low level of revenue mobilization for its level of per capita income and its development objectives. Low levels of revenues are due to narrow bases and low rates of certain taxes, but also to widespread tax evasion, lack of transparency, weak monitoring and controls, Value Added Tax (VAT) revenue leakages due to fraudulent invoicing, and high levels of informality. While it is critical to expand the tax base and raise certain tax rates to increase the tax-to-GDP ratio, a prerequisite for building political and public support for such fiscal reforms is to strengthen the regulatory framework to enhance tax collection, and re-build trust in SAT.

5. **Lack of resources is compounded by insufficient transparency and accountability in public finances.** Lack of transparency and wide discretion in procurement procedures have led to misallocation, limited competition, and possible misuse of public resources. Over the last decade, a very high share of the value of public procurement was contracted under non-competitive procedures (and likely at a higher cost), while at the same time, there were insufficient resources to procure certain essential goods, such as vaccines. There are also fiscal leakages in the civil servants payroll, as the current human resources management system is fragmented, and lacks transparency and controls. Moreover, anti-money laundering regulations provide insufficient controls to prevent laundering through the financial system, including of resources that are related to transactions with the public sector. Finally, there is limited capacity in the Public Ministry to prosecute public and private illegal behavior related to the misappropriation of public resources, which severely undermines governance and citizens' trust in public institutions.

6. **Despite these challenges, Guatemala has continued to maintain an adequate macroeconomic policy framework, although per capita growth remains persistently low.** Sound macroeconomic management, with a flexible exchange rate regime and fiscal discipline, helped the country weather the 2008-09 global financial crisis and the 2015 political crisis. Prudent fiscal policy, over time, is reflected in the low public debt level as percent of GDP (24 percent by 2015). Although this ratio is one of the lowest in the Latin America and Caribbean (LAC) region, the debt level is on the higher side in relation to the country's fiscal revenues. Since 2000, the economy has expanded at an average annual growth rate of 3.5 percent, below both the LAC and Central American averages. Moreover, per capita growth is stubbornly low, at 1.5 percent on average over the past decade (per capita gross national income increased to an estimated US\$3,943 in 2015), hampering the country's income convergence.

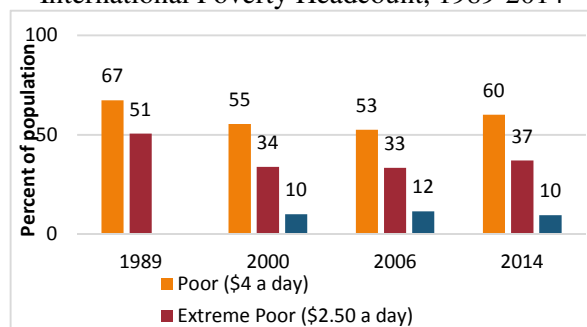
7. **Low per capita growth has not resulted in lower poverty rates.** Guatemala has the second highest poverty rate in LAC and is one of the few countries in the region that experienced an increase in income poverty in recent years. Poverty and extreme poverty increased between 2006 and 2014, from 52 percent to 60 percent and 33 percent to 37 percent, respectively.¹ The increases in overall poverty were largely driven by price increases, particularly for food, with low growth having only a partial mitigating effect. Mobility analysis between 2006 and 2014 also shows that more people fell into poverty than moved out of poverty. Inequality has been declining (the Gini coefficient was reduced from 0.55 in 2006 to 0.49 by 2014), but this was mainly driven

¹ Poverty calculated based on income.

by falling incomes at the higher end of the income distribution. There has been no shared prosperity, as average incomes of the bottom 40 percent of the population have declined over the 2000-2014 period.

Figure 1: Little Progress in Reducing Poverty in Recent Decades

International Poverty Headcount, 1989-2014

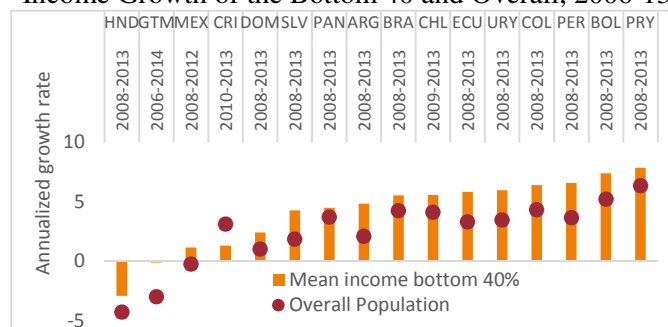


Source: For 1989, World Bank (2003). For other years, authors' calculations using the 2000, 2006, and 2014 National Living Conditions Survey.

Note: Based on income aggregate.

Figure 2: Income Growth was Negative while in Other LAC Countries it Rose

Income Growth of the Bottom 40 and Overall, 2006-13



Source: Authors' calculations based on SEDLAC (CEDLAS) and the World Bank.

Notes: Data are from the point closest to the years mentioned but are not exact: the Guatemala data are from 2006-2014 while for most of the other countries, the reference period starts in 2008.

2 MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

8. **Economic performance experienced an uptick in 2014-15, with growth just above 4 percent.** Private consumption remained the main contributor to growth supported by high remittances and a boost to disposable incomes resulting from lower international oil prices. Private investment also expanded, supported by credit growth, and was particularly dynamic in agriculture, manufacturing, telecommunications, construction and transport. In contrast, government consumption growth decelerated, in the context of lower tax revenues. Historically, Guatemala's economic growth has been lower than those of peers in Central America, but one of the least volatile in LAC.

9. **The current account deficit narrowed to an estimated 0.3 percent of GDP in 2015, and remained comfortably financed by foreign direct investment (FDI).** Double-digit growth in remittances supported by the on-going recovery in the United States (U.S.) did offset a marginal decline in export revenues, linked to a 10 percent decline in merchandise export prices even as the exported volume increased. Meanwhile, goods imports declined 3.5 percent, with oil imports declining by 30 percent and non-oil imports growing by 3 percent. The trade deficit has declined to 9.2 percent of GDP in 2015 from 10.6 percent of GDP in 2014, helped primarily by an important improvement in the terms of trade. The current account deficit was more than financed by FDI inflows which amounted to 1.9 percent of GDP. With FDI inflows and foreign public borrowing exceeding the current account deficit, international reserves increased, covering around 4.2 months of imports by the end of 2015.

Table 1: Guatemala—Key Economic Indicators, 2011-2018

	2011	2012	2013	2014	2015	2016	2017	2018
Real sector	Annual percentage change, unless otherwise indicated							
Real GDP	4.2	3.0	3.7	4.2	4.1	3.1	3.5	3.7
Per Capita GDP (in US\$)	3,239	3,343	3,488	3,715	3,943	4,168	4,303	4,536
<i>Contributions (percentage points):</i>								
Consumption	3.5	3.3	3.8	4.0	5.0	3.2	3.5	3.8
Investment	1.0	0.5	0.2	0.6	0.8	0.7	0.7	0.9
Net exports	-1.7	-0.6	0.1	-0.5	-2.3	-0.8	-0.8	-1.0
Unemployment rate (ILO definition)	4.1	2.9	3.0	2.8	3.0	3.2	2.9	2.8
GDP deflator	6.9	3.3	3.4	3.0	3.3	4.6	4.4	4.7
CPI (average)	6.2	3.8	4.3	3.4	2.4	4.3	4.6	3.9
Fiscal Accounts	Percent of GDP, unless otherwise indicated							
Revenues and grants	11.6	11.6	11.6	11.5	10.8	10.3	10.9	11.2
Expenditures	14.4	14.0	13.8	13.4	12.3	12.1	12.8	12.8
Overall balance	-2.8	-2.4	-2.1	-1.9	-1.4	-1.8	-1.9	-1.6
Non-Financial Public Sector Balance	-2.4	-2.0	-1.7	-1.5	-1.2	-1.6	-1.7	-1.4
Selected Monetary Accounts	Annual percentage change, unless otherwise indicated							
Credit to the private sector	14.1	17.7	12.0	8.8	12.8	--	--	--
Balance of Payments	Percent of GDP, unless otherwise indicated							
Current account balance	-2.8	-2.6	-2.5	-2.1	-0.3	0.2	-0.4	-1.1
Merchandise exports, f.o.b. (annual percentage change)	23.2	-4.0	0.8	7.9	-1.5	1.3	5.0	6.5
Merchandise imports, f.o.b. (annual percentage change)	20.9	2.3	3.3	4.3	-4.0	1.5	8.2	8.7
Remittances	9.5	9.5	9.5	9.7	10.1	10.4	10.4	10.2
Foreign direct investment	2.1	2.0	1.9	1.7	1.6	1.5	1.7	1.9
Gross reserves (months of imports)					4.2			
External public debt	11.8	12.5	13.1	12.0	11.5			
Terms of trade (annual percentage change)	4.2	-2.4	-3.3	0.6	2.5	0.9	-1.1	-0.6
Memorandum items								
GDP nominal in US\$ billion	47.7	50.4	53.9	58.7	63.8	69.0	72.9	78.6
Public sector debt (in percent of GDP)	23.9	24.4	24.8	24.6	24.2	24.3	24.4	24.4

Source: Guatemalan authorities, IMF staff estimates, and World Bank staff estimates.

10. **The inflation rate decelerated to 2.4 percent in 2015 from 3.4 percent in 2014.** Inflation has remained below the upper limit of the Central Bank's targeted range (4 percent \pm 1 p.p.) for most of 2015, largely due to lower oil prices and lower prices of some food items. With lower inflationary pressures, the Central Bank of Guatemala has cut the policy interest rate four times by a cumulative 100 basis points to 3 percent, over the course of 2015. The rates have been kept at 3 percent after the last cut in October 2015, even as inflation rose to 4.7 percent by August 2016, due to higher food prices and low base effect for transportation and utilities prices. The real exchange rate is assessed to be slightly undervalued, although the real effective exchange rate has appreciated in 2015 in line with the U.S. dollar and inflation differential with trading partners. Strong remittances inflows and positive terms of trade partly explain the appreciation.

Table 2: Guatemala—Fiscal Accounts of the Central Government, 2011-2018

	2011	2012	2013	2014	2015	2016	2017	2018
Revenues	11.6	11.6	11.6	11.5	10.8	10.3	10.9	11.2
Taxes	10.9	10.8	11.0	10.8	10.2	9.9	10.3	10.6
Direct taxes	3.4	3.4	3.8	3.9	3.6	3.6	3.6	3.6
Indirect taxes	7.4	7.4	7.2	6.9	6.6	6.3	6.6	7.0
Non tax revenues	0.6	0.7	0.6	0.6	0.6	0.3	0.6	0.5
Capital revenues, including donations	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Expenditure	14.4	14.0	13.8	13.4	12.3	12.1	12.8	12.8
Current Expenditures	10.5	10.7	10.8	10.5	10.1	9.6	10.3	10.4
Interest payments	1.5	1.5	1.6	1.4	1.4	1.5	1.5	1.4
Capital	4.0	3.3	3.0	2.9	2.2	2.5	2.5	2.4
Primary balance	-1.3	-0.9	-0.6	-0.4	0.0	-0.4	-0.4	-0.2
Balance	-2.8	-2.4	-2.1	-1.9	-1.4	-1.8	-1.9	-1.6
Non-Financial Public Sector Balance	-2.4	-2	-1.7	-1.5	-1.2	-1.6	-1.7	-1.4
Memorandum items:								
Debt as percent of revenues	203.6	209.4	211.3	211.1	224.4	237.2	224.1	218.7
Interest payments as percent of revenues	12.7	13.1	13.3	12.6	13.2	14.2	13.9	12.9

Source: Guatemalan authorities, IMF staff estimates, and World Bank staff estimates.

11. **Guatemala’s financial sector is dominated by banks² and appears to be sound.** Banks are profitable, liquid, well-capitalized, and domestically funded. The banking system has adequate financial-soundness indicators, with non-performing loans at 1.7 percent as of June 2016, and a capital adequacy ratio of 13.9 percent, above the Basel III requirements (all financial institutions are well above this requirement). Credit to the private sector grew by 12.8 percent in 2015, but financial depth remains below regional levels. Commercial bank deposits in foreign currency remained relatively stable at around 20 percent of total deposits. The financial system has not been significantly affected by loss of corresponding banking relations, with only eight correspondent banks having canceled or reduced the number of accounts with 10 small Guatemalan banks, although they continue to maintain relations with other entities of the Guatemalan banking system. The ten banks affected by cancelation or a reduction in the number of accounts continue to have relations with other correspondent banks. However, there are currency mismatches that stem from a moderately high share of dollar denominated loans and unhedged borrowers. Vulnerabilities also stem from strong foreign bank liabilities growth, and exposure of the financial system to sovereign debt.

12. **The fiscal deficit declined to 1.4 percent of GDP in 2015, below the budget target, reflecting further expenditure cuts.** Tax revenues declined to 10.2 percent of GDP by 2015, dragged down by both low oil prices impacting collections of the VAT on imports and other taxes, and a weakened revenue/customs administration. Meanwhile, direct taxes declined only marginally, in part due to the reduction in the profit tax collections. In addition, government revenues and grants from external sources declined, partly in relation to the 2015 political and

² The supervised financial system is made up of 103 financial institutions, including 17 commercial banks, 14 finance companies, and 6 off-shore companies. Banks account for 83.3 percent of assets, finance companies for 2.9 percent, offshore companies for 8 percent, and exchange rate houses and insurance companies for the remainder.

institutional crisis. This crisis also negatively affected budget execution, which together with cuts in capital investments and goods and services, lowered public spending by 0.7 percentage points to 12.3 percent of GDP, the lowest in 17 years. As a result, the government deficit declined to an estimated 1.4 percent of GDP in 2015 (from 1.9 percent in 2014). Public debt is low, at less than 25 percent of GDP, with nearly 50 percent held by domestic residents. However, it is on the high side relative to tax revenues at 224 percent.

Table 3: Guatemala—Balance of Payments Financing Requirements and Sources, 2013-18

	2011	2012	2013	2014	2015	2016	2017	2018
Financing requirements (US\$)	4,384	4,384	4,847	4,698	4,273	4,692	4,592	4,561
Current account deficit	1,351	1,310	1,351	1,229	202	-130	267	874
Medium and long-term debt amortiz	3,034	3,074	3,495	3,469	4,071	4,823	4,325	3,688
Financing sources (US\$)	4,384	4,384	4,847	4,698	4,273	4,692	4,592	4,561
Capital account flows (net)	9	17	28	24	26	10	9	9
Foreign direct investment	1,026	1,205	1,295	1,366	1,209	1,037	1,259	1,529
Public sector borrowing	1,393	1,041	1,177	1,113	1,375	1,160	1,271	1,331
Other capital flows (net)	2,191	2,627	2,924	2,255	2,082	3,453	2,338	1,491
Change in reserves (+ decrease)	-234	-506	-579	-61	-418	-968	-285	202

Source: Guatemalan authorities, IMF staff estimates, and World Bank staff estimates.

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

13. **Guatemala’s macroeconomic outlook is expected to remain stable over the medium-term.** Growth is expected to decelerate to around 3.4 percent over the 2016-2018 period, in the context of an uncertain external environment, tightened monetary conditions in the U.S., and higher oil prices towards the end of the projection period. Weaker government spending and slower export growth will contribute to the slowdown in growth in 2016 to 3.1 percent. Private consumption is expected to grow at a solid albeit slower pace. Meanwhile, the recovery in confidence levels that started in the second half of 2015, together with external demand from the U.S., should support private investment, particularly in the telecommunication sector. The service sector is expected to remain the main contributor to growth through 2018, contributing on average 2.2 percentage points to growth annually. Financial intermediation and communication are expected to remain among the more dynamic sectors, while commerce is also expected to expand at a solid rate, supported by strong remittances. The agriculture sector is expected to have one of the weakest contributions to growth, with growth driven primarily by the formal, more productive export-oriented sector. Sustained growth in the coffee sector is expected to help with poverty reduction. Robust external demand for textiles, in particular from the U.S. would also support growth in the manufacturing sector, although real appreciation in the Quetzal may affect export performance.

14. **The current account deficit is expected to increase gradually over the 2017-2018 period in line with negative terms of trade dynamics and sustained domestic demand, and will continue to be financed by FDI.** The current account deficit is expected to widen to 1.1 percent of GDP, as oil prices are projected to increase, even as exports are supported by the

implementation of free trade agreements and stronger external demand. Remittances are expected to continue to grow albeit at a more moderate pace over the 2016-2018 horizon, reflecting developments in the U.S. labor markets. FDI flows are expected to increase gradually and finance the current account deficit.

15. Inflation is projected to remain within the range targeted by the monetary authority with expectations anchored by prudent monetary policy. Inflation is expected to accelerate to 4.3 percent in 2016, on account of solid domestic demand, and average 4.2 percent over the 2017-2018 due to higher oil prices. Nevertheless, inflation is expected to remain within the targeted range, as the Central Bank is expected to tighten monetary policy if needed to anchor expectations. The efficiency of monetary policy will continue to be partly hampered by low financial intermediation. The normalization of the U.S. monetary policy, which started in December 2015, in the context of large foreign-denominated currency loans, could result in higher interest rates. In addition, adverse weather conditions and natural disasters represent a source of food price volatility.

16. The fiscal deficit is projected to widen to 1.8 percent of GDP and 1.9 percent of GDP in 2016 and 2017, respectively, before declining marginally in 2018. This outlook implies a broadly neutral fiscal stance. Fiscal policy is likely to remain prudent over the medium-term, with the Government generally containing expenditures in order to keep the fiscal balance from deteriorating. An improvement in budget execution is also expected in 2017-2018, and in particular, a recovery in capital spending following the under-execution in past years, and higher social priority spending, in line with the new administration's priorities. Accordingly, the 2017 budget draft law³ allocates more than 50 percent of the 2017 budget increase to health and the fight against malnutrition (or 6.1 percent of the total 2017 budget envelope) and 23 percent to security and justice.

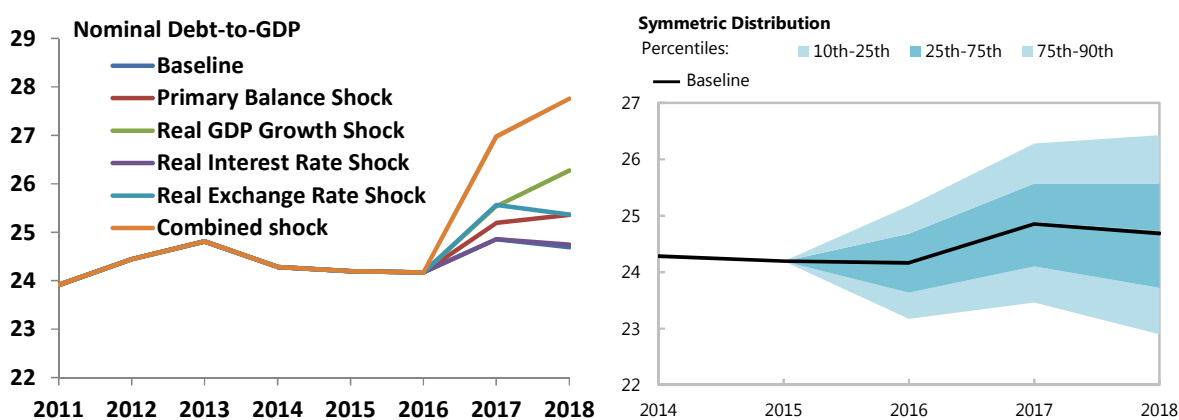
17. Fiscal revenues are expected to moderately recover, supported by the Government's measures to improve tax administration and compliance. Recovery of international oil prices is expected to lead to improvements in VAT collection on imports starting with 2017, and an increase in fuel royalties. Nevertheless, continued widespread tax evasion, informality, low rates and narrow bases, coupled with weak tax administration capacity, will continue to hinder the effectiveness of fiscal policy in fulfilling some of its key objectives, including service delivery and infrastructure to support growth. More structural reforms would be necessary to ensure increased effectiveness of the fiscal policy.

18. Public debt levels are assessed to remain sustainable under various shock scenarios and the risk of public external debt distress is assessed to be low. Under the baseline scenario, the public-debt-to-GDP is expected to stabilize at 24.4 percent of GDP by 2018, below that of countries with similar risk ratings, and below that of other Central American countries. A debt

³ The 2017 budget draft law presents a budget deficit of 2.2 of GDP. The budget for the Ministry of Public Health and Social Assistance (MSPAS) increases to 8.5 percent of the total envelope in 2017, while the budget for the Ministry of Social Development (MIDES) rises to 1.5 percent. In comparison, the 2016 budget allocated 7.8 percent of the overall budget envelope to MSPAS, 18.2 percent to the Ministry of Education, 5.1 percent to the Ministry of Communication, Infrastructure and Housing, 1.4 percent to MIDES, and 1.8 percent to the Ministry of Agriculture and Food.

sustainability analysis conducted by World Bank staff indicates resilience to various economic shock scenarios (see Figure 3). For example, a slowdown in real GDP growth of 1.2 percentage points (one standard deviation) will result in an increase in the public debt-to-GDP ratio to 26.3 percent by 2018. In the case of a primary balance shock, the debt-to-GDP rises to 25.4 percent, similar to the real exchange rate shock. A combined shock, that assumes a permanent ¼ standard deviation shock applied to growth rate, a 200 basis points shock to the interest rate, a real exchange rate shock of 7 percent, and a shock to the primary fiscal balance of baseline minus half of the 10-year historical standard deviation, would result in the public debt ratio stabilizing at close to 30 percent of GDP. One source of vulnerability relates to the debt profile, namely the share of public debt held by non-residents that at 49 percent is moderately high.

Figure 3: Guatemala – Public Debt Sustainability Analysis



Source: Guatemalan authorities, IMF, and World Bank staff estimates and projections.

Note: Individual shocks represent scenarios in which a permanent ¼ standard deviation shock is applied to the real interest rate, GDP growth rate, and the fiscal primary balance. The combined shock represents a scenario in which a similar shock is applied concomitantly to all variables (i.e., interest rate, GDP growth rate, and fiscal primary balance).

19. **Guatemala’s macroeconomic policy framework is sustainable over the medium-term and adequate for the proposed DPF; however, the macroeconomic outlook may be vulnerable to downside risks.** As a small, open economy, it is vulnerable to external shocks. Uncertainty in global market conditions could affect Guatemala’s macroeconomic performance. In particular, weaker than expected growth in the U.S., could affect exports, remittances and FDI flows, given that one million households depend on remittances from the U.S., around 33 percent of exports go to the U.S. and there are important U.S. FDI inflows. Tightening in the U.S. monetary conditions could result in substantial currency depreciation, as portfolio readjustments take place, and could affect asset quality through un-hedged borrowers. Conversely, continued real effective exchange rate appreciation would negatively affect competitiveness of exports. There are downside risks to the fiscal balances and growth, especially given the limited space for countercyclical spending in case of shocks (given the rigidity in public expenditures with mandatory allocations at approximately 88 percent of revenues). Furthermore, failure to reform SAT would undermine efforts to enhance tax collection, impacting much needed social and investment spending.

20. **Risks to the financial system stem from the relatively high dollarization of loans, and asset concentration.**⁴ Foreign-currency denominated loans have increased by 4.7 percent year-on-year, reaching 43 percent of total outstanding loans as of June 2016. The share of foreign-currency denominated loans to borrowers that do not have foreign currency earnings reached 40 percent by June 2016, an increase of 4 percentage points since 2011. Currency mismatches that stem from a high share of dollar denominated loans and unhedged borrowers are generating some risks to the system. Moreover, there are vulnerabilities emerging from the fact that some economic groups include financial conglomerates. Enhancing consolidated supervision of financial conglomerates would help strengthen resilience. An additional downside risk stems from reduction in global banks' provision of financial services, including withdrawal of correspondent banking services.

IMF Relations

21. **The Government maintains a dialogue with the International Monetary Fund (IMF) on macroeconomic policy in Guatemala.** The IMF concluded the Article IV in August 2016. The IMF's regional center for Technical Assistance for Central America and Dominican Republic, which is based in Guatemala City, provides technical support in several areas, including tax administration, financial supervision, external sector statistics harmonization, and national accounts statistics. World Bank and IMF staff teams coordinate their engagements closely.

3 THE GOVERNMENT'S PROGRAM

22. **The priorities of the Government as reflected in the General Policy of the Government for the 2016-2020 period are aligned with the National Development Plan (*K'atun, our Guatemala 2032*).** The Government developed the General Policy of the Government for the 2016-2020 building on the 2032 National Development Plan. It includes five strategic pillars: (i) instituting zero tolerance for corruption by fostering governance and transparency, in particular in the management of public funds, among other; (ii) improving the security situation by strengthening the police force, establishing stricter arms control and implementing integrated violence prevention programs, specifically in urban areas, among other; (iii) increasing access to better quality education by improving the overall learning environment, including by formulating a culturally sensitive national curriculum, as a foundation for the modernization of the national economy; (iv) increasing access to better quality health services by implementing the recently launched National Strategy to Reduce Chronic Malnutrition and ensuring universal access to primary health services, among other; and (v) generating good quality jobs by promoting financing for micro, small and medium enterprises and creating a more amenable business environment, among other.

⁴ Credit is concentrated in the consumption and the commerce sector, which together account for more than half of the credit), and in large enterprises (55 percent).

4 THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

23. **This programmatic DPF series supports selected aspects of the Government’s reform program, and its objectives are fully consistent with the World Bank Group’s CPF for Guatemala.** The proposed Operation forms part of a comprehensive World Bank engagement strategy, complements efforts of other development partners, and builds on lessons learned and progress achieved with previous World Bank operations. The Program Development Objectives of the series are to support the Government’s efforts to (i) enhance the policy and institutional framework to address primary health care deficiencies and chronic malnutrition; and (ii) strengthen the regulatory and institutional framework to improve governance of public resources and accountability. These objectives are fully aligned with the Government’s priorities of improving sustainability of fiscal accounts, building an open and transparent government, reducing chronic malnutrition, and ensuring timely supply of medicine.

24. **The design of the proposed Operation incorporates lessons from previous DPF operations.** The experience from the previous DPF series highlights the need to design operations with strong government ownership and taking into account weak governance and potential policy reversals, high turnover rates of technical personnel, and low implementation capacity. As a result, the proposed series supports a program of reforms that are the new administration’s top priorities and where there is full commitment to implementation. For example, the chronic malnutrition reforms are spearheaded by a Commissioner reporting directly to the President. Thus, the design of this DPF is simple, focusing on the critical areas that are building blocks for medium-term reforms, and based on strong analytical underpinnings. Finally, the reform program is complemented by technical assistance and two Investment Project Financing operations that would support the reforms in terms of implementation.

4.2 PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar 1: Enhancing the Policy and Institutional Framework to Address Primary Health Care Deficiencies and Chronic Malnutrition

25. **Guatemala continues to face significant challenges in achieving inclusive growth, in part due to unequal opportunities for its people to participate in the country’s development.** Reducing pervasive chronic malnutrition (stunting) is both one of the critical challenges and one of the key priorities of the Government, given its impact on individual welfare, costs to the society, and negative impact on growth. Chronic malnutrition affects the accumulation of human capital, perpetuating inequality and poverty across generations. Given the many dimensions that affect nutrition, including health care, social safety nets, environment, food, water and sanitation, a multi-sectoral strategy is needed. This DPF series supports key policy and institutional actions to address this critical developmental challenge, complementing other World Bank interventions, in particular the *Creceer Sano* Project that will support the National Strategy to Reduce Chronic Malnutrition, which prioritizes implementation in the seven poorest departments.

Primary Health Care

26. **Inadequate coverage due to the lack of a model to ensure broader access to primary health care, and limited funding, continue to impact health outcomes.** In 2014/15, only 52 percent of children 12 to 23 months of age in the lowest income quintile received all the required vaccinations, compared to 62.4 percent of children in the highest income quintile. The disparity is largely due to inequitable access to primary health care, with the majority of medical care centralized in the wealthier urban areas. Less than half of the population have access to primary health services since the Government discontinued the Extension of Coverage Program (PEC)⁵ in February 2015. The PEC, which provided basic health and nutrition services through non-governmental organizations (NGO), is being progressively replaced with services provided by staff of the Ministry of Public Health and Social Assistance (MSPAS). Although the public spending on health as a share of GDP increased from 1.8 percent in 2007 to 2.2 percent in 2013, it is lower than the LAC average (3.8 percent) and the lowest in Central America.⁶ Moreover, management of resources is inefficient and coordination among key institutions weak.⁷

27. **The approval of the MSPAS' new model of primary health care will provide the strategic direction for the expansion of an essential package of nutrition and health services, prioritizing areas previously covered by the PEC.** The new primary health care strategy aims to provide a holistic package of services, with a special emphasis on reducing maternal and child mortality and chronic malnutrition. Health institutional teams made up of MSPAS staff will provide services in existing health facilities as well as through mobile teams in areas that do not yet have any MSPAS facilities. The model will be rolled out, prioritizing areas with limited access to health care, high rates of chronic malnutrition, high rates of maternal mortality, and municipalities with high rates of extreme poverty.

Prior Action 1: *A Ministerial Decree (Acuerdo Ministerial) is approved creating the new primary health care model, including the expansion of an essential package of nutrition and health services.*

28. **Triggers.** To further support the delivery of the new primary health care model, DPF2 will support the adoption of a centralized procurement program for essential medicines and medical supplies for primary health care, which uses an interinstitutional agreement between the MSPAS and the Guatemalan Social Security Institute (IGSS) to standardize the bidding documents for essential drugs. This is expected to increase fiscal savings that could be used to expand coverage of primary health care services. Savings will also support the scale up of the Inclusive Health Model Information System (*Sistema de Información de Modelo Incluyente de Salud, SIMIS*), which covers all population groups and uses a multidimensional approach (individual-family community) to plan and monitor health care activities and results in the seven priority departments of the National Strategy to Reduce Chronic Malnutrition.

⁵ The PEC was established by the Government in 1997 to improve coverage of health and nutrition services to poor, rural, and largely indigenous areas.

⁶ World Bank (2016). Guatemala: Social Sector Expenditure and Institutional Review.

⁷ World Bank (2016). Health System Functional Review.

29. **Expected Results.** Implementation of these reforms is expected to contribute to increasing the percentage of children 12 months old in the areas prioritized by the National Strategy to Reduce Chronic Malnutrition receiving the complete vaccination scheme required for their age to 80 percent by 2018, and lowering the cost of the essential package of primary health care medicines by 5 percent.

Chronic Malnutrition

30. **Guatemala's children stunting rate is the highest in LAC and among the highest in the world.** Despite the fall in the chronic malnutrition rate from 55 percent in 1995 to 46.5 percent in 2014/15, Guatemala's stunting rate remains extremely high for its level of income. It is only exceeded by countries with significantly lower per capita incomes, such as Bangladesh and Ethiopia. Poor, rural, and indigenous populations are the most affected, with stunting rates of 66 percent, 59 percent, and 61 percent, respectively.

31. **Key drivers of chronic malnutrition are interlinked: low access to and quality of maternal and child health services, low birthweight, poor child feeding practices, and limited access to safe water.** Guatemala's high chronic malnutrition rate affects the quality of its human capital and, as a consequence, its growth and development potential. Various studies have shown that malnutrition contributes to higher mortality, increases incidence of non-communicable diseases, and lowers immunity, learning potential, and work productivity. Data from the 2014/15 National Maternal and Child Nutrition Survey shows that only 53.2 percent of children 0-5 months are exclusively breastfed and only 50 percent of children 6-23 months are adequately fed. In addition, many households still do not have access to drinking water. Only 71 percent of rural areas have access to piped water compared to 97 percent of urban areas.

32. **Fighting malnutrition requires a clear policy and institutional framework, and a coordinated approach.** The resolution of the National Council of Food Security and Nutrition (CONASAN) approving the strategic policy and institutional framework to reduce chronic malnutrition, and prioritizing the seven neediest sub-national jurisdictions (departments) for its implementation, contains a clear path in this regard. In addition, the President of Guatemala has created by Executive decree, a Presidential Commission for the Reduction of Chronic Malnutrition, indicating high level support to this agenda. The new strategic framework will put in place a multi-sectoral approach in coordination with civil society and institutions at the central, departmental, and municipal levels. The key priorities of the strategy include: (i) increasing access to, and strengthening the quality of, primary health and nutrition care services, including growth monitoring and promotion, and vaccinations of young children; (ii) supporting behavioral change at the community level, including promoting good hygiene and exclusive breastfeeding for children 0 to 6 months of age; (iii) improving access to safe drinking water and sanitation; and (iv) improving household income and resources to contribute to enhancing dietary quality.

Prior Action 2: *The framework to set policies to reduce malnutrition is established through (a) Executive Decree (Acuerdo Gubernativo) creating the Presidential Commission for the Reduction of Chronic Malnutrition; and (b) a Resolution of CONASAN approving the strategy to reduce chronic malnutrition and prioritizing the seven neediest sub-national jurisdictions (departments) for its implementation.*

33. **Triggers.** DPF2 will support the adoption, by the Presidential Commission, and implementation of a system to monitor and evaluate the implementation of the strategic policy and institutional framework to reduce chronic malnutrition.

34. **Expected Results.** Coverage of the health system for growth monitoring and promotion for children under 24 months old in the areas prioritized by the National Strategy to Reduce Chronic Malnutrition increases from 10 percent in 2015 to 30 percent by 2018. MSPAS will increase the minimum required check-ups for the growth monitoring and promotion to 8 for children 0-11 months and 6 for children 12 -24 months from 4 check-ups for children 0-11 months and 4 check-ups for children 12 -24 months old.

Social Assistance Policies

35. **The new administration is taking important steps to enhance efficiency of social spending to better use the limited public resources to support poor households in line with key national priorities.** Some of the main challenges in the area of social assistance relate to securing adequate funding, improving targeting, and prioritizing interventions that deliver more beneficial impacts to the poorest. Social assistance spending has declined in the past four years, and in particular, spending on cash transfers.⁸ The creation of the Ministry of Social Development (MIDES) and the establishment of the new Unique Registry of Beneficiaries and of the Social Information System) were positive developments in terms of strengthening the institutional framework and improving the coordination of programs. However, there is still a need to improve the quality and targeting of social spending in order to further prioritize limited resources to the poorest and support the achievement of national priorities, including reducing chronic malnutrition.

36. **The *Bono de Salud y Educación*, a conditional cash transfer (CCT) program, is an important social program but many eligible beneficiaries do not receive the full benefit amount because of its wide coverage and lack of resources.** The CCT program is doing well in reaching the poor by international standards (70 percent of its beneficiaries are poor)⁹ but its coverage has expanded overly rapidly, reaching 693,936 active households in 2015 (of which roughly 360,000 in the seven Departments prioritized by the nutrition strategy).¹⁰ As a result, budgetary transfers to MIDES for the implementation of the CCT have been insufficient and benefit payments have been rationed. This has resulted in a sizable percentage of eligible beneficiaries not receiving the full annual benefit in addition to lack of predictability in the timing of the transfers. While suffering from serious challenges, the program has the potential to contribute to the goal of reducing stunting rates in children 0-2 in targeted areas.

37. **The development and adoption of a new Geographic Targeting Methodology for social programs is critical to ensure that the limited resources reach the poorest.** The new

⁸ WB (2016): Guatemala: Social Sector Expenditure and Institutional Review. Spending levels in Guatemala are below those of all of its Central American neighbors. Spending as a share of GDP is less than one half the levels of Costa Rica and Panama, countries with much higher GDP per capita levels.

⁹ World Bank (2016). Guatemala: Social Sector Expenditure and Institutional Review, estimates based on household data and AdepT software.

¹⁰ MIDES, Memoria de Labores 2015

Geographical Targeting Methodology relies on all relevant existing data sources¹¹ to develop rankings of municipalities using key criteria, such as poverty levels and different types of vulnerabilities. Using municipal-level maps for targeting is essential as poverty can be significantly reduced when targeting smaller geographic units. This is particularly important for Guatemala given that there are large territorial inequalities and poverty is highly correlated with location. Therefore ensuring some degree of geographic targeting/prioritization would go a long way in maximizing the impact of spending on social assistance. Furthermore, the adoption of analytically solid geographic targeting criteria ensures a more transparent allocation and prioritization of scarce resources.

Prior Action 3: *A Ministerial Decree (Acuerdo Ministerial) is approved adopting a Geographical Targeting Methodology for MIDES programs and projects with a view to enhance targeting to the poor and efficiency of social spending.*

38. **In addition, MIDES has reformed the in-kind food transfer program (Food-CCT), to improve targeting and efficiency, and strengthen overall transparency.** In May 2016, MIDES redesigned the existing food assistance program for the Department of Guatemala,¹² substituting an inefficient and poorly targeted¹³ in-kind transfer with a conditional transfer, significantly reducing distribution costs and increasing overall transparency. The in-kind program was overextended, poorly targeted and highly inefficient because of the need to purchase and distribute in-kind items (the purchase and distribution of the food items contained in the basket was more expensive than the individual items would have been for beneficiaries). In contrast, the conditional transfer is provided to beneficiaries selected via a socio-economic needs assessment through debit cards that can be used only in pre-identified food establishments, conditional on their participation in information and awareness workshops on nutrition, consumer rights and financial literacy. The new transfer has been rolled out in the three poorest municipalities of the Department of Guatemala City,¹⁴ and coverage is expected to increase slowly in 2017, in line with budgetary availability in order to protect regularity of monthly transfers (ten transfers per year).

Prior Action 4: *A Ministerial Decree (Acuerdo Ministerial) is issued to restructure the Food-CCT (Transferencia Monetaria Condicionada para Alimentos) by replacing the in-kind transfer with a periodic conditional transfer that is: (i) targeted better to poor and extreme poor households enrolled on the basis of socioeconomic indicators, (ii) provided through a debit card to be used in pre-identified food establishments, and (iii) geo-referenced to beneficiary household data.*

39. **Trigger.** DPF2 will continue to support the Government's effort to improve targeting and prioritization of social spending. An inter-ministerial agreement between MIDES and the Ministry of Public Finance will be issued that (a) defines a prioritization list for CCT in the seven

¹¹ Poverty Maps based on 2002 National Population Census, 2011 Rural Poverty Maps, 2015 National school children height/age Census, 2014 School Dropout statistics, Municipal level Vulnerability Index, Food and Nutrition Insecurity Vulnerability Index.

¹² The *Bolsa Segura* program provided costly in-kind food assistance to roughly 200,000 beneficiaries in the Department of Guatemala, making it the second largest social assistance program implemented by MIDES.

¹³ World Bank (2016). Guatemala: Social Sector Expenditure and Institutional Review.

¹⁴ Chuarrancho, San Raymundo, and San Juan Sacatepéquez, with about 3,200 beneficiaries enrolled.

departments prioritized by the National Strategy to Reduce Chronic Malnutrition; and (b) guarantees timely and full quarterly budget releases to MIDES to cover the health transfer (*Bono de Salud*) for beneficiary households in the priority areas. Moreover, DPF2 will support the adoption of measures to strengthen the mechanism for the flow of funds for CCT transfers to improve reliability of funding and timeliness for recipients.

40. **Expected Results.** The supported measures are expected to contribute to an increase in the percent of 0-2 children in priority municipalities that complete the full cycle of nutrition verification from 0 percent to 50 percent and to an increase in the number of on-time transfers paid in a year to recipients of the health transfer (*Bono de Salud*) in areas prioritized by the National Strategy to Reduce Chronic Malnutrition from 1 in 2015 to 4 by 2018.

Pillar 2: Strengthening the Regulatory and Institutional Framework to Improve Governance of Public Resources and Accountability

41. **Strengthening the governance of scarce public resources is critical to improve service delivery and achieve better development outcomes.** The new administration that took office in January 2016 has a strong mandate to fight corruption and has a window of opportunity to adopt far-reaching policy and institutional changes to strengthen institutions, and restore citizen confidence in them after the 2015 institutional crisis. This DPF series is part of World Bank support to this important agenda and complements other projects, in particular, the Transparency and Efficiency in Tax Administration Project that will support the implementation of reforms to increase levels of compliance with tax and customs obligations.

Tax Administration

42. **SAT suffers from a weak governance structure, lack of adequate controls, excessive scope for discretionality, lack of transparency in tax collection, weak compliance mechanisms, and limited enforcement.** Moreover, revenue collection is undermined by widespread tax evasion, VAT revenue leakages and high levels of informality. This has been further exacerbated by the 2015 crisis, which revealed profound legal and institutional constraints in its governance structure. Establishing a new legal and governance framework is at the core of the Government's strategy to rebuild trust in tax authorities, address tax administration institutional constraints to ensure that tax collection targets are achieved, and lay a solid foundation for future tax policy reforms.

43. **The legal framework and governance model of the SAT have been unable to deal with the build-up of corruption networks and political interference that prevented SAT from fulfilling its mandate.** Among the most important issues identified by various diagnostics are: (i) the inadequate composition of the Board of Directors and the lack of proper separation of roles and responsibilities within the SAT governance structure, posing risks of conflict of interest; (ii) the lack of a credible and independent administrative instance for tax appeals; (iii) the limited investigation and tax enforcement capacity in SAT resulting, among other things, from existing bank secrecy legal restrictions; (iv) the lack of proper and effective internal control mechanisms capable of preventing and detecting mismanagement and corruption; and (v) the difficulties of the Ministry of Public Finance in exercising a more effective monitoring of SAT performance.

44. **The Law for Strengthening Fiscal Transparency and Governance amends the SAT Organic Law and related laws to address critical governance issues in SAT.** Key changes include: (i) the creation of an administrative tribunal within SAT (TRIBUTA) in charge of administrative tax appeals; (ii) the modification in the nomination and appointment procedures for the SAT Superintendent, the members of the Board of Directors and the members of the TRIBUTA, limiting political interference in the nominations; and (iii) the relaxation of bank confidentiality provisions granting SAT the authority, with a competent judge order and as part of an administrative process, to access tax payer financial information for auditing and investigation purposes, in line with good international practice. The latter will significantly strengthen SAT's ability to detect inconsistencies in tax declarations as well as to exercise the tax auditing functions in a more effective way.

Prior Action 5: *Amendments to the organic Law of the Tax Administration Superintendence (SAT) and related Laws, including provisions to limit bank secrecy embedded in these related Laws, are enacted to improve governance of the SAT and enhance tax collection compliance.*

45. **Triggers.** DPF2 will support the Government's commitment to continue strengthening the governance of SAT through the issuance of executive regulations to support the implementation of the amendments to the SAT Law, specifically: (a) internal organizational procedures for SAT and for the operations of the new Administrative Tax Appeal Tribunal (TRIBUTA); (b) procedures for timely and effective access and use of financial information under bank confidentiality rules; and c) enactment of the Ethics Code.

46. **Insufficient transparency, control, and accountability mechanisms created a fertile ground for corruption.** Lack of proper and effective internal control mechanisms, and, in particular, the lack of a specialized internal investigation unit, prevent the detection of conflict of interest situations and corrupt activities. The Internal Audit unit has proven ineffective in examining and evaluating the implementation of internal control systems. The creation of an internal affairs/investigation unit institutionalizes control mechanisms and conveys a strong signal to SAT staff that there will be accountability. This unit will report directly to the Board of Directors, and will have the capabilities to detect irregular situations, receive complaints, and conduct investigations on possible mismanagement and fraudulent activities.

Prior Action 6: *Establishment of an internal affairs/investigation unit in the SAT, with a view to strengthen internal accountability.*

47. **Triggers.** To further enhance controls and tax collection, the trigger for DPF2 will support the enactment of amendments to the tax code to strengthen control, enforcement, and overall compliance with the VAT.

48. **Expected Results.** The measures supported are expected to contribute to a reduction of the estimated VAT non-compliance level from 34.2 percent of potential VAT revenues in 2015 to 29 percent by 2018.

Procurement Reform

49. **The 2015 political developments prompted the resumption of a reform of the procurement law, with an emphasis on transparency, limiting discretion, and increasing competition to protect limited fiscal resources.** The large number of regulations, criteria and contracting entities has undermined the integrality of the public procurement system, reduced operational efficiency, discouraged participation of suppliers and competition, inhibited citizen oversight, and enabled corruption. An inadequate regulatory body has affected procurement implementation, while lack of guidelines, standard bidding documents and adequate controls have made it difficult to prevent biased awards due to excessive discretionary participation requirements and inadequate evaluation criteria. Alternative mechanisms, such as public trusts (*fideicomisos*), a common practice in Guatemala, have limited competition, leading to discretionary awarding of contracts. Collusion practices are also frequent as many processes are restricted to few suppliers. Indeed over the last decade, a very high share of the value of public procurement was contracted under single source or emergency procedures that are not competitive. From 2013 to 2015, more than 70,000 processes were carried out using direct contracting compared to less than 2,000 processes conducted competitively and approximately 2,400 under exceptional clauses. This situation is likely to have generated severe fiscal leakages on an already small spending envelope.

50. **The procurement reform establishes stricter procedures and improved controls, with a focus on strengthening transparency, competition, and accountability in public procurement practices.** The amendments call for the creation of a General Register for State Procurement, a separate specialized entity in charge of registering vendors and the contracts awarded to them, and more effective control and further strengthening of the public procurement system. The new legal framework encourages more competition and value for money, which would also help to reduce fiscal leakages. The law restricts the use of exception methods or direct contracting, encouraging the use of competitive selection methods and standard specifications, especially through the use of framework agreements. The reform also incorporates new procurement methods, such as reverse auction, concessions, and e-procurement, which are more efficient procurement methods. Furthermore, it defines procedures for renting or procuring institutional premises and equipment.¹⁵ Importantly, the law mandates that all public trusts apply procurement provisions, closing a loophole that have allowed the use of public trusts to circumvent public procurement procedures. The reform also entails changes to framework agreements, with clear guidelines in terms of process, procedures, accountability, and public information and transparency. These agreements provide flexibility to governments that are unable to commit to a fixed procurement amount at the beginning of the fiscal year, as is the case in Guatemala.

Prior Action 7: *Amendments to the Procurement Code (Ley de Contrataciones del Estado) are enacted, and corresponding regulations are issued, with a view to increase competition and limit discretion in procurement procedures, including procurement procedures for public trusts (fideicomisos).*

¹⁵ During 2013-2015, more than 400 premises and 90 equipment contracts were rented under use of exceptional methods.

51. **Triggers.** DPF2 is expected to support further institutional reforms to the public procurement framework, including the creation of: (a) a General Directorate of Acquisitions; and (b) a general registry of public acquisitions.

52. **Expected Results.** The procurement reform supported by the series is expected to contribute to increasing competition in public procurement, as well as an increase in the share of public procurement executed through competitive processes in total value of executed public procurement percent to 52 percent by 2018 from 36 percent in 2015.

Human Resource Management

53. **Guatemala's human resources management system is fragmented, lacks transparency, and offers significant room for efficiency gains to safeguard limited public resources.** Human resources management remains one of the weakest areas of the public administration. According to the Civil Service Development Index (2004-11/13), Guatemala's score has remained unchanged during the 2004-2013 period, scoring 24 out of 100 points in the index, well below the regional average of 38 points for year 2013. The Central government wage bill represents the main budget rigidity, accounting for 41 percent of current spending, and has increased from 3.1 percent of GDP in 2008, to 4.2 percent of GDP by 2015. On a limited budget envelope, any leakages that are likely in this system, could be used more efficiently.

54. **Proliferation of parallel hiring schemes, including through different budget lines that are not governed by the Civil Service Law, have resulted in a high degree of uncertainty regarding the size of public sector, including of the Central Government public workforce.**¹⁶ Estimations from the National Office of Civil Service (ONSEC) indicate that there are 389,000 workers, a number that is significantly higher than the figure of the Ministry of Public Finance (of 312,175 workers).¹⁷ Furthermore, there is no unified job classification, or single system of remunerations for the Central Government, resulting in rules that can differ substantially from one institution to another. Additionally, there are no links between the databases of active and retired workers, which not only makes it difficult to visualize the availability of vacancies and posts in an institution but also means that a retired worker could be earning a pension and still be receiving his salary as an active employee.

55. **A census of public servants is the first step to understand the scope of the problem and follow up with measures to improve efficiency.** Since taking office in 2016, the Government announced a public sector workforce census¹⁸ to assess the number of employees under different classifications, identify and eliminate "ghost" workers, and improve the predictability of the wage bill. Its findings will strengthen the human resources management strategy, and enhance controls

¹⁶ For the past decade, hiring freezes and budget cuts in the central public administration has given rise to the hiring of workers through non-personal services, often referred as Grupo 1.

¹⁷ Data as of December 20, 2015 provided by the Guate nóminas system, for workers classified under Personal Services (Group 0) which includes: (i) 253,428 public servants (known in Guatemala as Permanent Personnel – Budgetary line 011), (ii) 10,052 hired and temporary workers (Budgetary line 022), (iii) 39,087 - supernumeraries – workers conducting temporary functions of short duration (Budgetary line 021), and (iv) 9609 technical and professional consultants (Budgetary line - 029).

¹⁸ The Census will be conducted in the central administration executive branch (including Ministerios, Secretarías and Fondos).

by systematizing and channeling all transactions through an updated payroll. Given multiple hiring mechanisms, the census will not only capture information on workers categorized as employees, civil servants, public officials, among others, but also individuals who provide technical, professional, and consulting and advisory services. The census will also establish through which budget line they are paid for their service and their characteristics.

***Prior Action 8:** For purposes of enhancing payroll controls of public sector employees, the government mandated: (a) the carrying out of a public sector workforce census, and (b) the use of the integrated system of human resources and of the unified payroll system (Guatenóminas), as evidenced by Executive Decree No. 180-2016, dated September 21, 2016.*

56. **Trigger.** The public sector workforce census is completed and payroll systems are updated.

57. **Expected Results.** It is expected that the measures supported by the DPF series would contribute to the updating and verification of the profiles, and certification of identity of 95 percent of the public employees of the public sector workforce that are paid through Guatenóminas; and would contribute to eliminating discrepancies and increase transparency in the management of human resources of the central public sector.

Anti-Money Laundering Policies

58. **Guatemala has taken steps to enhance banks' customer due diligence, perform national risk assessments, and increase the frequency of inspections to mitigate risks from corruption and money laundering activities.** The Financial Intelligence Unit (IVE) has taken steps to enforce the policy of identification of the final beneficiaries, and apply penalties for non-compliance with the obligation to report suspicious activities. As a result of increased on-site supervision by IVE, several money laundering schemes were uncovered and several bank managers and small individual customers are being investigated for money laundering. Further measures are necessary to ensure that funds derived from corruption entering the financial system are detected and confiscated, and to facilitate the identification of corrupt officials. Financial regulated entities need to build robust internal processes especially for products, services, transactions, and clients that require enhanced scrutiny. In particular, closer scrutiny is required for contractors of the state (*Contratistas Proveedores del Estado-CPE*), legal entities linked to politically exposed persons,¹⁹ and those that have business relationships with jurisdictions with high-risk of corruption/money laundering cases. Moreover, financial institutions need to identify, understand and mitigate these specific risks. Guatemala completed the national risk assessment for money laundering and terrorism financing in 2015 and is taking measures to apply its recommendations in the operations of the financial sector.²⁰ Implementing a sound risk-based anti-money laundering and counter terrorism Financing (AML/CFT) supervision and increasing its effectiveness requires closing a series of key gaps. One key deficiency, highlighted by the most recent AML/CFT Mutual Evaluation Report carried out by the Financial Action Task Force of

¹⁹ In Guatemala, financial institutions need to determine if clients are politically exposed persons and if so, obtain senior management approval for establishing the business relationship; establish the source of wealth and funds and carry out enhanced ongoing monitoring of the business relationship. Guatemalan high level officials are considered politically exposed persons.

²⁰ The ML/TF risk assessment was conducted with the participation of a diverse group of AML/CFT stakeholders and the facilitation of the World Bank Group.

Latin America, is that certain activities of lawyers and notaries that may be at risk for money laundering or terrorism financing are not currently regulated in Guatemala, although regulation is part of the international standards (FATF recommendations).

59. The new regulation to enhance due diligence by financial institutions of business relationships with CPEs facilitates the generation of intelligence for launching corruption investigations and makes it harder to move proceeds of corruption through the financial system. The enhanced due diligence measures will require that, on the one hand, any company that opens a bank account has the obligation to indicate whether it is a CPE or not, and the name of the state entity with whom it has business. On the other hand, the financial institutions have the obligation to: (i) check the CPE status of new and existing clients in the GUATECOMPRAS public procurement database; (ii) verify who is the real beneficiary of the procurement from the CPEs; (iii) closely monitor CPE transactions in order to ensure that the nature, frequency and volume of transactions are consistent with expected economic-financial activities of the company; and (iv) identify owners, beneficiaries and legal representatives of CPEs and closely monitor their transactions. These measures will help identify suspicious transactions related to a public official (or entity controlled by a politically exposed person) or CPE, which provided services to a state entity, that is in fact controlled by a public official or his/her family member.

60. In addition, the regulations instruct banks, finance companies, offshore entities, and other financial entities, on the identification, evaluation, understanding of money laundering/terrorism financing risks, and mitigation measures. The regulations provide detailed guidance to the regulated entities on the risk management methodology. These include factors that might affect the risks associated with the clients of an institution, including activities with high volume cash transactions, and businesses with international activities, among others. These regulations are mandatory, and failure to comply with them entails administrative penalties (fines). Regulated entities also have the obligation to share with the IVE the internal documents that record the implementation of the risk management methodology.

Prior Action 9: *The Superintendence of Banks has strengthened its supervision of financial transactions of High Risk Clients, including significant transactions with Public Sector Entities, by mandating:*

(a) *financial institutions to carry out enhanced due diligence of business relationships with State Contractors, including bank accounts;*

(b) *all Regulated Entities to comply with procedures for managing and addressing the risks related to money laundering and financing of terrorism, all pursuant to the Borrower's Law No. 67-2001, as amended to the date of this Agreement, and as evidenced by the Special Verification Intendent's letter No. 3654-2016 dated September 30, 2016.*

61. Trigger. To further enhance the AML/CFT system, the DPF2 will support the reform of the AML/CFT law to align it with international standards and strengthen its effectiveness. The draft legislation will close gaps in a number of key areas such as: i) identification of beneficiary owners of bank accounts or transactions; and ii) inclusion of lawyers, notaries, accountants and auditors among regulated entities (when they are involved in activities such as sale of real estate, operation or management of legal entities, purchase of shares or interests in corporations or other legal entities).

62. **Expected Results.** Fifty percent of financial entities (banks, finance companies and offshore banks) are expected to include an assessment of their specific money laundering/terrorism financing risks in their compliance manuals as well as measures for monitoring, management and mitigation. IVE is also expected to verify compliance of CPEs with the regulation on administration of risks and enhanced due diligence measures for 82 percent of the entities (banks, finance companies and offshore banks).

Independence and Capacity of the Public Ministry

63. **Guatemala's legal and judicial reform efforts gained new momentum in the aftermath of the 2015 political and institutional crisis.** The prosecutors have been investigating members of the political and business elites, while seizing many of the incriminating documents. This has been possible through the efforts of local anti-corruption champions, with help from the International Commission against Impunity in Guatemala (CICIG), which was created by the United Nations to provide technical expertise to the local authorities. Success with this endeavor will be critical to restore the trust of people in state institutions. Indeed over the years, citizen satisfaction with justice administration has been consistently ranked low. The general public criticizes the judiciary for lack of independence, impartiality, transparency and accountability.

64. **The Organic Law of the Public Ministry allowed for political interference and was not properly regulating the professional career of prosecutors, among other shortcomings.** It was also not conducive to an evaluation and disciplinary system, negatively affecting the performance of the Ministry. More importantly, the President could dismiss the Attorney General based only on an evaluation of his/her performance, without a conviction being required, leaving the office exposed to political interference.

65. **The amendments to the Organic Law of the Public Ministry introduce some important principles of civil service reform to ensure independence and shield prosecutors from political pressures.** The amendments strengthen the professional career of the prosecutors, technically and administratively, so that appointments are not discretionary. Furthermore, it insulates the Ministry from political interference as dismissal of the Attorney General will require a conviction. In addition, the Public Ministry's Council, which had authority on administrative issues (such as dismissal of prosecutors for lack of qualifications or involvement with illicit activity) was dissolved and replaced by the General Supervising Committee, the head of which is appointed by the Attorney General. Several specialized offices within the Public Ministry were created (*fiscalias especiales*), including the ones related to administrative and economic crimes, extortions, crimes against women, and children protection.

66. **One of the most important recent developments is related to the establishment of a Disciplinary Commission (*Junta Disciplinaria*), with a mandate to investigate disciplinary cases within the Public Ministry.** Formerly, a Council exercised authority on these matters and tackled administrative issues, such as dismissal of prosecutors for lack of qualifications or involvement with illicit activity, with mixed results. Bottlenecks to efficiently resolving cases were identified and led to the decision to dissolve the Council. It is expected that under the new structure, the cases presented to the Disciplinary Commission will be protected against political interference

and resolved more efficiently, since the procedures are now oral. The new oral procedures are replacing the original ones that were based on written submissions, which were cumbersome, inefficient and lacking transparency. Future reforms may tackle the issue of limited presence in the territory, since the newly inaugurated *Junta Disciplinaria* is located in the Capital, which is relatively far to reach from some of the most remote locations.

Prior Action 10: *Amendments to the Public Prosecution Law are enacted with a view to strengthen the independence and capacity of the Public Ministry to combat corruption; and a Disciplinary Commission is created (Junta Disciplinaria).*

67. **Expected Results.** The measures supported by the DPF series are expected to contribute to increasing the number of Prosecutor’s Offices specialized in handling corruption cases (*Agencias de la fiscalía especializada contra la corrupción*) from 1 to 4. This is an instrumental output that shows commitment to the reforms and pace of implementation.

68. **The DPF benefited from a broad range of analytical work carried out in recent years by the World Bank and other institutions.** These include the Guatemala Economic Diagnostic for National Action, an update to the Financial Sector Assessment Program and a number of technical assistance activities on Behavior-Informed Public Policy work, health and nutrition, social protection, agriculture and migration, among others, which, together with the SCD provide the analytical underpinnings for the DPF.

Table 4: DPO Prior Actions and Analytical Underpinnings

Prior Actions	Analytical Underpinnings Key Findings
Pillar 1: Enhancing the Policy and Institutional Framework to Address Primary Health Care Deficiencies and Chronic Malnutrition	
<p>Prior Action #1: A Ministerial Decree (<i>Acuerdo Ministerial</i>) is approved creating the new primary health care model, including the expansion of an essential package of nutrition and health services.</p>	<ul style="list-style-type: none"> • Rolling out the new primary health care model which is based on a life cycle approach that goes beyond the maternal and child focus of the previous model. (Guatemala: Social Sector Expenditure and Institutional Review (2016); Health System Functional Review (2015))

Prior Actions	Analytical Underpinnings Key Findings
<p>Prior Action #2: The framework to set policies to reduce malnutrition is established through (a) Executive Decree (<i>Acuerdo Gubernativo</i>) creating the Presidential Commission for the Reduction of Chronic Malnutrition; and (b) a Resolution of CONASAN approving the strategy to reduce chronic malnutrition and prioritizing the seven neediest sub-national jurisdictions (departments) for its implementation.</p>	<ul style="list-style-type: none"> • Chronic malnutrition is pervasive and represents a substantial cost to Guatemala. Solving the malnutrition challenge will require multi-sectoral interventions in the areas of health, education, water and sanitation, and agriculture. Guatemala SCD (2016) • A longitudinal study designed to measure the effect of consuming a highly nutritious dietary supplement (atole) on a range of outcomes was implemented in Guatemala between 1966 and 1977. A follow-up study was carried out in 1988-89 to look at the more long-term effects. There is an extensive bibliography on these studies. A summary report on this bibliography was prepared by Mantorell (1995)
<p>Prior Action #3: A Ministerial Decree (<i>Acuerdo Ministerial</i>) is approved adopting a Geographical Targeting Methodology for MIDES programs and projects with a view to enhance targeting to the poor and efficiency of social spending.</p>	<ul style="list-style-type: none"> • While social spending in Guatemala has increased as a share of total spending, the quality of this expenditure remains of concern, especially with respect to its geographical targeting and technical efficiency (SCD, 2016) Need for increased spending in social assistance interventions, better coordination among implementing agencies, and revision of targeting tools to ensure decent coverage of programs among the poorest. (Central America Social Expenditures and Institutional Review (2016))
<p>Prior Action #4: A Ministerial Decree (<i>Acuerdo Ministerial</i>) is issued to restructure the Food-CCT (<i>Transferencia Monetaria Condicionada para Alimentos</i>) by replacing the in-kind transfer with a periodic conditional transfer that is: (i) targeted better to poor and extreme poor households enrolled on the basis of socioeconomic indicators, (ii) provided through a debit card to be used in pre-identified food establishments, and (iii) geo-referenced to beneficiary household data.</p>	<ul style="list-style-type: none"> • The Cost of Hunger: Social and economic impact of child undernutrition in Central America and the Dominican Republic (Martinez, R. and A. Fernandez; 2008) • The study estimates that the cost of malnutrition in 2004 represented 11.4 percent of GDP in Guatemala (Protegiendo la nueva cosecha: Una análisis del costo de erradicar el hambre en Guatemala, 2012-2021; UNICEF/ Instituto Centroamericano de Estudios Fiscales, 2011). Social Sector Expenditure and Institutional Review (2016)

Prior Actions	Analytical Underpinnings Key Findings
Pillar 2: Strengthening the Regulatory and Institutional Framework to Improve Governance of Public Resources and Accountability	
<p>Prior Action #5: Amendments to the organic Law of the Tax Administration Superintendence (SAT) and related Laws, including provisions to limit bank secrecy embedded in these related Laws, are enacted to improve governance of the SAT and enhance tax collection compliance.</p> <p>Prior action #6: Establishment of an internal affairs/investigation unit in the SAT, with a view to strengthen internal accountability.</p>	<ul style="list-style-type: none"> • Guatemala IAMTAX Diagnostic (2014) • Forum on Tax Administration: Working smarter in restructuring the administration, in compliance, and through legislation (OECD 2012) • ICEFI: Proposal of Reforms to the Organic • Law of SAT (2016)
<p>Prior action #7: Amendments to the Procurement Code (<i>Ley de Contrataciones del Estado</i>) are enacted, and corresponding regulations are issued, with a view to increase competition and limit discretion in procurement procedures, including procurement procedures for public trusts (<i>fideicomisos</i>).</p>	<ul style="list-style-type: none"> • Identifying options for improving framework agreements for the purchase of medicines in Guatemala, rapid diagnostic –Quick Gains- (2009-2010)
<p>Prior action #8: For purposes of enhancing payroll controls of public sector employees, the government mandated: (a) the carrying out of a public sector workforce census, and (b) the use of the integrated system of human resources and of the unified payroll system (<i>Guatenóminas</i>), as evidenced by Executive Decree No. 180-2016, dated September 21, 2016.</p>	<ul style="list-style-type: none"> • The new census of public employees that is under discussion by the government that will collect and link information on contractors, employees, and procurement systems is a concrete step towards increasing transparency in the sector and also, it is expected, to improve the effectiveness of spending (SCD, 2016) • IADB assessments (2004, 2014) • IADB Civil Service Development Index
<p>Prior action #9: The Superintendence of Banks has strengthened its supervision of financial transactions of High Risk Clients, including significant transactions with Public Sector Entities, by mandating:</p> <p>(a) financial institutions to carry out enhanced due diligence of business relationships with State Contractors, including bank accounts;</p> <p>(b) all Regulated Entities to comply with procedures for managing and addressing the risks related to money laundering and financing of terrorism, all pursuant to the Borrower’s Law No. 67-2001, as amended to the date of this Agreement, and as evidenced by the Special Verification Intendent’s letter No. 3654-2016 dated September 30, 2016.</p>	<ul style="list-style-type: none"> • CFATF in 2016 • National Money Laundering and Terrorism Financing Risk Assessment TA using WBG methodology (2015) • National Money Laundering and Terrorism Financing Risk Assessment completed by Guatemala authorities (2015) • Action Plan of the National ML/TF Risk Assessment (2015); Anti-Money Laundering and Combating the Financing of Terrorism Mutual Evaluation Report- GAFILAT (2016)

Prior Actions	Analytical Underpinnings Key Findings
<p>Prior action #10: Amendments to the Public Prosecution Law are enacted with a view to strengthen the independence and capacity of the Public Ministry to combat corruption; and a Disciplinary Commission is created (<i>Junta Disciplinaria</i>).</p>	<ul style="list-style-type: none"> • Challenges and proposed recommendations with respect to “Carrera profesional” – professional career in the Public Ministry (including the role and responsibility of the Attorney General, special prosecutors, administrative staff, entry level exam, training, disciplinary actions, etc.) “La carrera profesional en la administración de justicia”, 2010, Asociación de Investigación y Estudios Sociales: • Challenges and proposed recommendations with respect to the professional career of judges. “Mejores jueces, menos impunidad”, Guatemala, June 2015, Asociación de Investigación y Estudios Sociales/Iniciativa ThinkTank, KAS. • Recommendations on the implementation of the new amendments: “Aspectos a considerar en la implementación de las reformas a la ley orgánica del MP”, June 2016, Asociación de Investigación y Estudios Sociales. • Recommendations of 56 technical discussions with the participation of 1,004 experts from August 2014 until March 2015: “Proyecto Política Criminal Democrática del Estado”, MP, 2016. • Current challenges of the criminal justice: “Desafíos actuales de la justicia penal”, December 2015, Guatemala, Asociación de Investigación y Estudios Sociales/Iniciativa ThinkTank, KAS. • Strategic criminal prosecution: “La persecución penal estratégica, una política criminal de Guatemala”, A Rodriguez, Guatemala, 2009. • CICIG technical report on impunity 2015, • CICIG Report on the election of the Attorney General, 2010.

4.3 LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

69. **The proposed DPF is the central policy piece of the CPF that is presented in parallel to this operation.** The CPF is anchored in the Government’s strategy reflecting Guatemala’s commitment to, inter alia, fight corruption and enhance transparency, improve tax collection, and enhance welfare outcomes, especially related to health and nutrition. Within the framework of the CPF, the proposed DPF is influencing outcomes in the two pillars: (i) fostering social inclusion, in particular increasing access to basic services for vulnerable groups; and (ii) addressing bottlenecks to sustainable growth, in particular improving transparency of revenue management.

70. **The proposed DPF is interlinked and complements the investment project financing operations under preparation, by supporting the policy reforms related to improving malnutrition and enhancing tax administration.** While the DPF would provide support for related policy reforms related to primary health care and malnutrition, the project will focus on reducing the prevalence of risk factors for chronic malnutrition, by delivering an inter-sectoral package of services to address chronic malnutrition drivers, supporting provision of a package of nutrition and health services to mothers and children, promoting behavioral change interventions, and improving access to safe drinking water and sanitation, among others. Similarly, the Transparency and Efficiency in Tax Administration Project will support the implementation of the new Organic SAT Law by focusing on initiatives to modernize tax collection processes, improve tax enforcement and customs procedures, and strengthen information management, as well as actions to improve transparency and efficiency of public procurement. World Bank Analytical and Advisory Activities are also supporting the DPF program, both on the fiscal and social sectors, including the recently prepared 2016 SCD, Health System Technical Assistance, Social Expenditure and Institutional Review, Fiscal Rules in Central America, and Behavioral Insights in Tax Compliance, among others.

CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

71. **The reforms supported by the DPF are anchored in the Government’s National Development Plan: *K’atun, our Guatemala 2032*, which underwent extensive public consultations.** The K’atun Plan was developed within the National Development Council System, which includes Government agencies and civil society organizations. Following the diagnostic phase of the Plan’s development, a series of consultations and workshops were conducted by the authorities and included participation of cooperatives, unions, indigenous groups (Maya and other groups), a large number of NGOs (focused on women, youth, children, rural workers and national peasants organizations), and small and medium enterprises. Moreover, specific reforms supported by this Operation went through comprehensive consultations. For example, the amendments to the public prosecution law were consulted by the authorities with over 1,000 specialists in more than 50 technical roundtables, and in close coordination with the civil society organizations, in particular, with the alliance of several NGOs promoting human rights (*Convergencia por los Derechos Humanos*). The procurement reform and amendments to the SAT organic law were also subject to extensive consultations, with the participation of civil society organizations, think tanks, academia, public institutions, the private sector, and specialized NGOs.

72. **This operation has been prepared in consultation with development partners.** The World Bank has coordinated with IABD (that is also preparing a development policy loan) to ensure consistency and complementarity of the policy dialogue. The World Bank and IMF have maintained a close dialogue, particularly in the area of macroeconomic monitoring. With the IMF’s regional center for Technical Assistance for Central America and Dominican Republic, the collaboration has focused on tax administration. The dialogue on primary health care and malnutrition has also benefited from collaboration with IADB, USAID, and Spanish/EU Cooperation.

5 OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

73. **This DPF supports policy and institutional actions that are expected to have either positive or neutral effects on poverty.** Reforms that support the improvement of primary health care and reduction of chronic malnutrition, as well as targeting of social programs to the poorest municipalities (Pillar 1) will reduce poverty in the short run and help to break the cycle of poverty in the longer term. Reforms to enhance governance of public resources and accountability (Pillar 2) are expected to benefit the economy as a whole, hence having a broadly neutral effect on poverty. However, as increased revenues will likely be translated into higher social spending, given that as per the Constitution 40 percent of the revenues are earmarked (of which a large share is for social spending) these reforms could potentially have positive poverty and social effects. The Census of Public Servants (Prior Action 8) could, if followed by an update of the payroll as expected, potentially lead to a decline in the payroll in the public sector. However, it is not expected to significantly impact the poor as only 2.1 percent of poor and extreme poor are public sector employees.

74. **The new primary health care model (prior action 1) will increase access to primary health care, helping to fill the gaps created by the closure of the PEC in 2014.** In 2014, 72 PEC contracts were suspended, leaving approximately 2.3 million people with no access to primary health care. In February 2015, the MSPAS cancelled the remaining PEC contracts. The new primary health care model, by prioritizing the expansion of the essential package of nutrition and basic health services in areas with limited health care service, high rates of chronic malnutrition and maternal mortality, is expected to help improve the welfare of the poor today and their opportunities going forward.

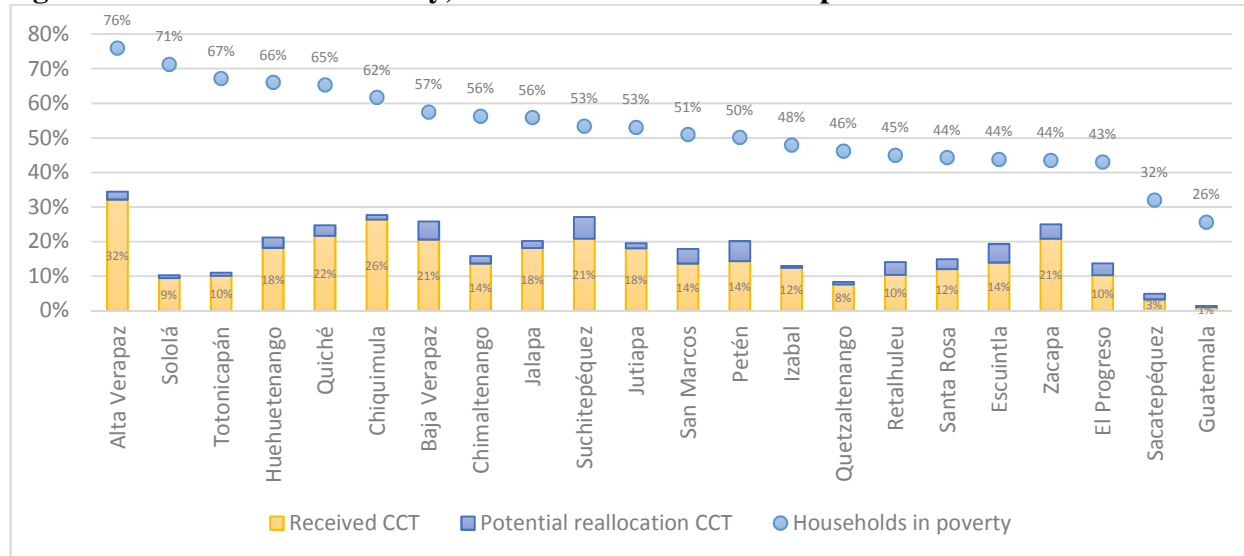
75. **Prioritizing the seven poorest departments for implementation of the national strategy to reduce chronic malnutrition (prior action 2) will contribute to reducing stunting, and thus, other developmental outcomes for children.** Approximately 46.5 percent of all children are stunted, while in the prioritized departments the average stunting rate reached 62 percent in 2014, and as high as 72 percent in Totonicapán and Huehuetenango. The negative effects of chronic malnutrition are felt at the individual level as children suffering from stunting have poorer health and educational levels. At the economic level, people suffering from stunting have poorer job outcomes and earning potential as well.

76. **The effect of adopting a Geographical Targeting Methodology for MIDES programs (prior action 3) is expected to affect both poverty and social indicators as well as reduce disparities among regions.** Prioritizing the poorest seven departments can potentially reduce regional gaps and lower poverty. In 2014, 74 percent of the population in the seven poorest departments were poor, while on average 60 percent of the national population lived in poverty²¹. According to the latest household survey (National Living Conditions Survey 2014), in the poorest departments as a whole, of all households in poverty (and thus eligible for the Bono Seguro-CCT) 74 percent do not receive the benefits they are entitled to receive. Among the extremely poor

²¹ Using US\$4 per day poverty line.

households, 57 percent do not receive Bono Seguro-CCT. However, nationally, 15.6 percent of the households that received Bono Seguro-CCT were not under the poverty line and thus, were ineligible for participation in the program. If the funds were to be reallocated from ineligible to eligible households in extreme poverty, 22.2 percent of the extremely poor households in the seven poorest departments could become new beneficiaries with the subsequent positive effects on poverty, health and education. Furthermore, if as expected the number of on-time transfers in the prioritized departments increased to 4, this could lead to a reduction in extreme poverty from 37 to 35.9 in the priority areas, or approximately 201,000 people.

Figure 4: Households in Poverty, CCT Beneficiaries and Impact of Potential Reallocations



Source: Authors' calculations using National Living Conditions Survey 2014.

Note: Not all poor and extreme poor households are eligible for the CCT program as there is a small percentage of households that do not have children under 15 (a criteria of eligibility). But the differences are very small.

77. **The replacement of the in-kind transfer with periodic conditional transfer and the improved targeting (prior action 4) is expected to contribute to poverty reduction.** Currently the Food-CCT is poorly targeted. Only 44 percent of the beneficiaries are poor. Given the limited scale of this program the effect on poverty reduction will not be large. However, by ensuring that compliance with the conditions of the program are monitored, the nutrition and health outcomes for the receiving households, will improve in the long-term, and thus, the potential for these households to break the cycle of poverty.

5.2 ENVIRONMENTAL ASPECTS

78. **The policies and institutional actions supported by the proposed operation are not likely to cause adverse significant effects on the country's environment, forests, and other natural resources (see Annex 4).** Pillar 2 supports regulatory reforms to improve tax administration, including tax compliance. Enforcement of VAT and import duties of products typically associated with environment degradation (e.g. fuels,) could potentially contribute to positive effects.

5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

79. **The Public Financial management system has experienced improvements in expenditure management systems in recent years.** Recent reforms include a new Organic Budget Law (October 2013) to improve public expenditure management, which helps prevent new arrears, increases budget flexibility and comprehensiveness, improves cash management through the use of a Treasury Single Account, and enhances controls of trust funds. Consolidated government financial statements are prepared annually, but some omissions continue to exist. Public accounts are consolidated within three months of the end of the fiscal year, and include information on revenue, expenditure, and financial assets and liabilities of most central government entities, however information on other government entities are not included. Accounts are audited by the General Audit Office annually, including information on municipal expenditures and trust funds that are submitted to the legislature within five months of the end of the period covered. However, audit reviews are mostly limited to compliance and individual transactions rather than systemic issues affecting budget management and performance. Information on annual budget formulation, in-year and year-end budget reports and external audit reports are publicly available. The general government budget is made publicly available on the Ministry of Public Finance's website.

80. **However, challenges remain as weaknesses in the budget process and practices, continue to hamper the effectiveness.** Some of these challenges relate to: (i) budget preparation based on past allocations (rather than sectoral plans); (ii) excessive reallocations during budget year; (iii) deficient registry of accruals (floating debt) and monitoring of arrears that affects the budget credibility and makes inconsistent the medium-term budget framework; and (iv) internal controls that are generally transaction based, but may be deficient in some important areas. The Ministry of Public Finance has expressed commitment to start working on strengthening public finances, focusing on reducing spending by enhancing efficiency in public management and improving the performance of public sector entities. Concrete actions require a strategic and collaborative approach involving development partners.

81. **The foreign exchange control environment of the Central Bank is adequate, external auditing systems are in place, and international foreign currency reserves are managed according to prudent international practice, according to the last available IMF Assessment Report²².** The external audit for the last year provided a clean opinion and was carried out in accordance with International Standards of Audit. The audit does not reveal any significant issue related to the internal control environment. Financial Statements of the Central Bank are prepared in compliance with accounting regulations of the organic law that differs from the International Financial Reporting Standards in: (i) the treatment of amounts due from the Government for past losses; (ii) fixed assets without fair value periodic reevaluation; and (iii) adjustments of income and expenses of previous years that should be adjusted on the relevant fiscal year instead of on the year of adjustment if significant.

82. **The proposed loan will follow World Bank's disbursement procedures for development policy loans.** Once the loan becomes effective, at the request of the Borrower, the

²² The last available IMF Safeguard Assessment of the Guatemala Central Bank was issued on September 9, 2009.

proceeds from the loan will be deposited into an account at the Central Bank of Guatemala, designated by the Borrower (in foreign currency that forms part of the country's official foreign exchange reserves) and acceptable to the Bank. The Borrower shall ensure that upon the deposit of the loan proceeds into said account, an equivalent amount is credited in the Borrower's budget management system, in a manner acceptable to the Bank. The government will provide to the Bank within 30 days of the disbursement date a written confirmation that: i) the amount disbursed is deposited in the foreign currency account; and ii) credited to the budget management system. If the proceeds of the loan are used for ineligible purposes as defined in the Loan Agreement, IBRD will require the Borrower to, promptly upon notice from IBRD, refund an amount equal to the amount of said payment to IBRD. Amounts refunded to the Bank upon such request shall be cancelled.

5.4 MONITORING, EVALUATION AND ACCOUNTABILITY

83. **The Ministry of Public Finance is responsible for the monitoring and evaluation of the program supported by this DPF series.** As the main implementing agency, it will coordinate with other Government ministries and agencies involved in the implementation of the series, in particular MIDES, SAT, and MSPAS. Together with Ministry of Public Finance, these institutions will collect the necessary data to assess implementation progress and report it to the Bank. The monitoring and evaluations systems are deemed adequate.

84. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate GRS, please visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

6 SUMMARY OF RISKS AND MITIGATION

85. **The overall risk to the achievement of the Program Development Objectives of the DPF series is assessed as substantial.** Political, governance, fiduciary risks, as well as risks related to sector strategies and policies, institutional capacity for implementation and sustainability, and stakeholders' risks contribute to an overall rating of substantial risk. Guatemala is recovering from a profound institutional crisis. While this situation originated at the tax administration, it helped uncover corruption schemes that reached the highest level of government. These practices are difficult to detect and deter and rooting them out of the system requires sustained policy and institutional efforts. The substance of the policy and institutional change supported, by design, help as mitigation mechanisms.

86. **Political, and governance risks are high, and are related to the highly polarized political landscape and vested interests.** The program supports critical reforms that have been firmly led by the new Government. These are, however, complex and highly sensitive reforms in the country's political economy, and pursued by an administration without a long track record. The vested interests and the highly polarized political climate could undermine the authorities' efforts to pursue politically sensitive reforms. For example, the proposed AML/CFT reforms (to be supported under the second DPF in the series) may also prove to be contentious and may be affected by opposition in parliament. Reforms could be reversed (in the past legal claims have been submitted before the Constitutional Court challenging the constitutionality of reforms) or watered down. The authorities have thus far demonstrated commitment to the reform program. Furthermore, the Government has taken measures to help mitigate these risks by engaging the support of international partners, including the World Bank, in these critical areas and by raising awareness of the importance of addressing these issues. In addition, the World Bank will continue to work with other partners and International Financial Institutions on designing and tracking the reform program and will remain engaged through policy dialogue and technical assistance. Furthermore, civil society organizations that are energized following the political events in 2015 are likely to help keep pressure on the authorities and vested interest to sustain reforms.

87. **Risks related to sector strategy and policy are also substantial.** In the past, frequent change in policy, strategic priorities, and ministerial and technical staff delayed implementation of development projects and hindered the ability to sustain and institutionalize policies over time. The new administration that took office in January 2016 has a strong mandate to improve transparency and restore confidence in the tax and customs administration, in particular in the context in which more Guatemalans demand change in how the State manages public funds. Similarly, malnutrition is at the forefront of the Government's agenda as a key developmental challenge. To mitigate these risks the Government, with the support of development partners, is implementing reforms that have strong buy-in from a wide array of stakeholders and that build capacity both within institutions and at the local level to ensure lasting results. In-depth dialogue between the Government and the WB to institute long-term planning in project execution and sector strategies, as well as strengthening sector institutions will also help mitigate these risks.

88. **Limited institutional capacity may affect the implementation of some reforms.** A key risk relates to the institutional capacity to implement, monitor and evaluate the multi-sectoral National Strategy to Reduce Chronic Malnutrition. The strategy requires integrated participation of several actors at national and local levels and strong local-level technical and institutional capacity. The new primary health care model may also be affected by limited capacity. Challenges may also arise with respect to the social program reforms, given that the MIDES has been recently created (in February 2012) and has limited institutional capacity. Also low enforcement capacity related to tax administration/tax collections represents a risk. The recent institutional crisis in SAT has affected the limited trust in the state, and constrained progress on the tax reforms and transparency agenda. The reform efforts supported by this programmatic operation, and the fact that reforms supported under the DPF are being complemented with two Investment Project Operations under preparation, Crecer Sano Project and the Transparency and Efficiency in Tax Administration, help mitigate these risks.

89. **Fiduciary risk is considered substantial mainly due to governance issues.** Key risks emerge from the use uncompetitive framework agreements, weaknesses in budget execution, weak and/or lack of internal controls, which affect implementation and overall budget credibility. The Government reform program is beginning to address this through changes to the legal procurement framework with respect to competitive methods, accountability and transparency. These efforts will be accompanied by the Transparency and Efficiency in Tax Administration Project that will support transparency, integrity, and institutional development in SAT.

Risk Categories	Rating (H, S, M or L)
1. Political and governance	High
2. Macroeconomic	Moderate
3. Sector strategies and policies	Substantial
4. Technical design of project or program	Moderate
5. Institutional capacity for implementation and sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and social	Low
8. Stakeholders	Substantial
Overall	Substantial

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions DPF 1	Triggers for DPF 2	Results Indicators (baseline: 2015, target: 2018; unless otherwise noted)
<i>Pillar 1: Enhancing the policy and institutional framework to address primary health care deficiencies and chronic malnutrition</i>		
<p>Prior Action 1: A Ministerial Decree (<i>Acuerdo Ministerial</i>) is approved creating the new primary health care model, including the expansion of an essential package of nutrition and health services.</p>	<p>Trigger 1: A centralized procurement program for essential medicines and medical supplies for primary health care is adopted, which uses an interinstitutional agreement between MSPAS and IGSS to standardize the bidding documents for essential drugs.</p> <p>Trigger 2: Scale up of the health information system (<i>Sistema de Información de Modelo Incluyente de Salud SIMIS</i>) to cover all population groups and use a multidimensional (individual-family community) approach to plan and monitor health care activities and results in the seven priority sub-national jurisdictions (departments).</p>	<p>Percent of children 12 months old in the areas prioritized by the National Strategy to Reduce Chronic Malnutrition receiving the complete vaccination scheme required for their age: Baseline: 74 percent Target: 80 percent</p> <p>The cost of the essential package of primary health care medicines²³ is reduced: Baseline: Q397.07 Target: 5 percent lower</p>
<p>Prior Action 2: The framework to set policies to reduce malnutrition is established through (a) Executive Decree (<i>Acuerdo Gubernativo</i>) creating the Presidential Commission for the Reduction of Chronic Malnutrition; and (b) a Resolution of CONASAN approving the strategy to reduce chronic malnutrition and prioritizing the seven neediest sub-national jurisdictions (departments) for its implementation.</p>	<p>Trigger 3: A system to monitor and evaluate the implementation of the strategic policy and institutional framework to reduce chronic malnutrition has been adopted by the Presidential Commission and is under implementation.</p>	<p>Coverage of the health system for growth monitoring and promotion²⁴ for children under 24 months old in the areas prioritized by the National Strategy to Reduce Chronic Malnutrition: Baseline: 10 percent Target: 30 percent</p>

²³ This package includes 46 medicines and the cost is equivalent to the sum of the prices per unit provided by MSPAS. It does not include micronutrients, vitamin A and family planning methods, as these are purchased in a centralized manner.

²⁴ The minimum required check-ups will increase to 8 check-ups for children 0-11 months and to 6 check-ups for children 12 -24 months old, from 4 check-ups for children 0-11 months and 4 check-ups for children 12 -24 months old, respectively.

<p>Prior Action 3: A Ministerial Decree (<i>Acuerdo Ministerial</i>) is approved adopting a Geographical Targeting Methodology for MIDES programs and projects with a view to enhance targeting to the poor and efficiency of social spending.</p> <p>Prior Action 4: A Ministerial Decree (<i>Acuerdo Ministerial</i>) is issued to restructure the Food-CCT (Transferencia Monetaria Condicionada para Alimentos) by replacing the in-kind transfer with a periodic conditional transfer that is: (i) targeted better to poor and extreme poor households enrolled on the basis of socioeconomic indicators, (ii) provided through a debit card to be used in pre-identified food establishments, and (iii) geo-referenced to beneficiary household data.</p>	<p>Trigger 4: An inter-ministerial agreement between MIDES and the Ministry of Public Finance is issued that (a) defines a prioritization list for CCT in the seven departments prioritized by the National Strategy to Reduce Chronic Malnutrition; and (b) guarantees timely and full quarterly budget releases to MIDES to cover the health transfer (<i>Bono de Salud</i>) for beneficiary households in the priority areas.</p> <p>Trigger 5: Adoption of measures to strengthen the mechanism for the flow of funds for CCT transfers to improve reliability of funding and timeliness for recipients.</p>	<p>Percent of 0-2 children in priority municipalities that complete the full cycle of nutrition verification: Baseline: 0 percent Target: 50 percent</p> <p>Number of on-time transfers paid in a year to recipients of the health transfer (<i>Bono de Salud</i>) in areas prioritized by the National Strategy to Reduce Chronic Malnutrition: Baseline: 1 Target: 4</p>
<p><i>Pillar 2: Strengthening the regulatory and institutional framework to improve governance of public resources and accountability</i></p>		
<p>Prior Action 5: Amendments to the organic Law of the Tax Administration Superintendence (SAT) and related Laws, including provisions to limit bank secrecy embedded in these related Laws, are enacted to improve governance of the SAT and enhance tax collection compliance.</p> <p>Prior Action 6: Establishment of an internal affairs/investigation unit in the SAT, with a view to strengthen internal accountability.</p>	<p>Trigger 6: Executive regulations for the implementation of the amendments to the SAT Law were issued, specifically: (a) internal organizational procedures for the SAT and for the operations of the new Administrative Tax Appeal Tribunal (TRIBUTA); (b) procedures for timely and effective access and use of financial information under the Bank Confidentiality rules; and c) enactment of the Ethics Code</p> <p>Trigger 7: Amendments to tax code are enacted to strengthen control, enforcement, and overall compliance with the VAT.</p>	<p>Estimated VAT non-compliance level (as a share of potential VAT revenues) is reduced Baseline: 34.2 percent Target: 29 percent</p>
<p>Prior Action 7: Amendments to the Procurement Code (<i>Ley de Contrataciones del Estado</i>) are enacted, and corresponding regulations are issued, with a view to increase competition and limit discretion in procurement procedures, including procurement procedures for public trusts (<i>fideicomisos</i>).</p>	<p>Trigger 8: Further institutional reforms to the public procurement framework are implemented, including the creation of: (a) a General Directorate of Acquisitions; and (b) a general registry of public acquisitions.</p>	<p>Share of public procurement executed through competitive processes in total value of executed public procurement: Baseline: 36 percent Target: 52 percent</p>

<p>Prior Action 8: For purposes of enhancing payroll controls of public sector employees, the government mandated: (a) the carrying out of a public sector workforce census, and (b) the use of the integrated system of human resources and of the unified payroll system (<i>Guatenóminas</i>), as evidenced by Executive Decree No. 180-2016, dated September 21, 2016.</p>	<p>Trigger 9: The Public Sector Workforce census is completed and payroll systems are updated.</p>	<p>Percent of public employees of the Executive²⁵ who are paid through the unified payroll system (<i>Guatenóminas</i>) with updated and verified profiles and certified identity: Baseline: 0 percent Target: 95²⁶ percent</p>
<p>Prior Action 9: The Superintendence of Banks has strengthened its supervision of financial transactions of High Risk Clients, including significant transactions with Public Sector Entities, by mandating:</p> <ul style="list-style-type: none"> (a) financial institutions to carry out enhanced due diligence of business relationships with State Contractors, including bank accounts; (b) all Regulated Entities to comply with procedures for managing and addressing the risks related to money laundering and financing of terrorism, all pursuant to the Borrower’s Law No. 67-2001, as amended to the date of this Agreement, and as evidenced by the Special Verification Intendent’s letter No. 3654-2016 dated September 30, 2016. 	<p>Trigger 10: Amendments to the Anti-money laundering/ financing of terrorism law are enacted to align it with international standards and strengthen the effectiveness of the AML/CFT system.</p>	<p>Percent of financial entities (banks, finance companies and offshore banks) that include in the compliance manual their specific ML/TF risks and assessment as well as measures for their monitoring, management and mitigation: Baseline: 0 Target: 50 percent</p> <p>Percent of financial entities (banks, finance companies and offshore banks) for which the Financial Intelligence Unit (<i>IVE</i>) checks compliance with the regulation on administration of risks and enhanced due diligence measures for CPEs: Baseline: 0 Target: 82 percent</p>
<p>Prior Action 10: Amendments to the Public Prosecution Law are enacted with a view to strengthen the independence and capacity of the Public Ministry to combat corruption; and a Disciplinary Commission is created (<i>Junta Disciplinaria</i>).</p>		<p>Number of Prosecutor’s Offices specialized in handling corruption cases (<i>agencias de la fiscalía especializada contra la corrupción</i>) created: Baseline: 1 Target: 4</p>

²⁵ Includes the Presidency of the Republic, Ministries, Departments and other units under the Executive.

²⁶ Includes lines 011, 021, 022, 029 and excludes line 31, due to the fact that a prerequisite module for the registry has not been developed, it also excludes employees linked to the National Security.

ANNEX 2: LETTER OF DEVELOPMENT POLICY

MINISTERIO DE FINANZAS PUBLICAS
GUATEMALA, C. A.

002690

12 de octubre de 2016

Doctor
Jim Yong Kim
Presidente del
Grupo del Banco Mundial
Washington D.C., USA

Señor Presidente:

El Gobierno presidido por el licenciado Jimmy Morales diseñó su Plan de Gobierno 2016-2020, bajo un enfoque que tiene como premisa mejorar el nivel de vida de los guatemaltecos y reducir la pobreza a través de una gestión pública con orientación hacia resultados, con efectividad, seguimiento y evaluación permanente, implementando políticas que estimulen la provisión eficiente de servicios básicos de educación, salud y nutrición.

Con ese propósito, el Gobierno está implementando un Plan basado en dos grandes temas, democracia participativa y gestión territorial, los cuales incluyen cinco ejes: Transparencia, Salud, Educación, Desarrollo Económico y Seguridad Ciudadana.

Sobre la base de esos cinco ejes, se han desarrollado doce prioridades que marcarán el rumbo de la actual Administración de Gobierno: i) Transparencia: Gobierno Abierto y Transparente; ii) Salud: Suministro oportuno de Medicamentos Convencionales y Alternativos y Disminución de la Desnutrición Crónica (10%); iii) Educación: Educación Alternativa Escolar y Tecnología en el Aula; iv) Desarrollo Económico: Nuevas Empresas, Fomento del Turismo, Infraestructura y Sostenibilidad Fiscal; y, v) Seguridad Ciudadana: Control de Fronteras, Prevención de la violencia y Apoyo al Sector Justicia.

La estrategia de asistencia en negociación con el Banco Mundial contempla, entre otros aspectos, el acompañamiento y apoyo a la implementación del Plan de Gobierno referido, a través del otorgamiento de dos Préstamos Programáticos de Política de Desarrollo. El objetivo de estas Operaciones será crear espacio fiscal y ampliar las oportunidades para los segmentos más vulnerables de la sociedad. Para el efecto, se brindará apoyo a dos áreas de política claves: i) Construyendo las bases para una política y marco institucional para ayudar a resolver las deficiencias de atención primaria de salud y la desnutrición crónica; y,



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ii) El fortalecimiento de la gobernabilidad de la gestión de los recursos públicos y la rendición de cuentas.

En ese sentido, la primera operación será denominada Primer Préstamo de Políticas de Desarrollo para la Mejora de la Gobernanza de los Recursos Públicos y Nutrición, y los recursos estarían siendo destinados a brindar apoyo presupuestario a las necesidades de financiamiento del Estado. De esa cuenta, el objetivo general del Programa, será apoyar los esfuerzos del Gobierno en: i) la construcción del marco de política institucional dirigido a las deficiencias en la atención primaria de salud y la desnutrición crónica; y, ii) el fortalecimiento del marco regulatorio e institucional para el mejoramiento de la gobernanza de los recursos públicos y la rendición de cuentas.

Con base en lo expuesto, y en el marco del compromiso del Gobierno de la República de Guatemala se han realizado las siguientes acciones:

1. *Mejorar el marco de políticas e institucional para abordar las deficiencias de la atención primaria de salud y la desnutrición crónica:* El Gobierno de Guatemala está comprometido en continuar fortaleciendo los procesos presupuestarios a fin de incrementar la eficiencia y efectividad de las instituciones públicas, para que atiendan la demanda actual y futura de sus servicios prestados con el fin de no descuidar las coberturas de atención a los grupos más vulnerables (protección del presupuesto social) y, por otro lado, dinamizar las inversiones focalizándolas en proyectos y programas prioritarios.

De esa cuenta, se han adoptado las siguientes medidas:

- Se emitió el Acuerdo Ministerial No. 261-2016 por parte del Ministerio de Salud Pública y Asistencia Social por medio del cual se acuerda definir e implementar el Modelo Incluyente de Salud (MIS), que tiene por objeto contribuir a la transformación del sistema de salud a partir de la propuesta de bases y lineamientos para un primer nivel de atención en salud incluyente, fundamentado en el derecho a la salud, la pertinencia intercultural, la perspectiva de género y de atributos óptimos como base fundamental del sistema público de salud en Guatemala.

El MIS se basa en tres perspectivas, que son: El derecho a la salud, la perspectiva de género y la interculturalidad. Desarrolla una estrategia programática operativa que integra las normas de atención y de vigilancia de salud del Ministerio de Salud Pública y Asistencia Social (MSPAS), y que consta de los tres programas de salud siguientes:



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1) el Individual, dirigido a la atención curativa y preventiva; 2) el Familiar, con énfasis en la atención preventiva para la unidad familiar; y, 3) el Comunitario, dirigido a la promoción de la salud.

- Se emitió el Acuerdo Gubernativo No. 45-2016 por medio del cual se creó la Comisión Presidencial para la Reducción de la Desnutrición Crónica, instancia facilitadora y promotora de los mecanismos de prevención y tratamiento de la desnutrición crónica para el desarrollo humano y el mejoramiento de la calidad de vida de los niños menores de los cinco años del país. Asimismo, en la Segunda Sesión del Consejo Nacional de Seguridad Alimentaria y Nutricional (CONASAN), se aprobó la Estrategia para la Prevención de la Desnutrición Crónica, según consta en el punto Tercero del Acta Número Cero Dos Guión Dos Mil Dieciséis (02-2016) de dicha sesión.
 - Se emitió el Acuerdo Ministerial No. DS 42-2016 del Ministerio de Desarrollo Social por medio del cual se aprobó el Documento de Focalización Geográfica de Programas y Proyectos de ese Ministerio, que servirá como instrumento de ayuda para hacer más eficiente la ejecución de los programas sociales.
 - Se emitió el Acuerdo Ministerial No. DS-24-2016 del Ministerio de Desarrollo Social por medio del cual se reforma el Acuerdo Ministerial del Programa Social “Mi Bolsa Segura”, en el sentido de adicionar la Transferencia Monetaria Condicionada para Alimentos a dicho Programa, como mecanismo de protección social que genera condiciones para la asistencia alimentaria y el acceso a productos de la canasta básica alimentaria a las familias que viven en condición de pobreza y pobreza extrema. Además, el Acuerdo Ministerial No. DS-26-2016 por medio del cual se acuerda el Manual Operativo que contiene las normas operativas de la intervención de dicha transferencia.
2. *Fortalecer el marco regulatorio e institucional para mejorar la gestión de los recursos públicos y la rendición de cuentas:* Un objetivo clave del Programa de Gobierno es mantener unas finanzas públicas disciplinadas y ordenadas, que a la vez coadyuven al desarrollo y a la disminución de la pobreza del país, y no comprometan su estabilidad macroeconómica con déficits fiscales elevados e insostenibles. Además, existe interés en mejorar la administración tributaria, los procesos de contrataciones y la transparencia del sector financiero en Guatemala, por medio de medidas de política orientadas al incremento de los ingresos tributarios y fortalecimiento de la prevención del lavado de activos.

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De esa cuenta, se han adoptado las siguientes medidas:

- Por medio de Decreto No. 37-2016, por medio del cual el Congreso de la República aprueba la Ley para el Fortalecimiento de la Transparencia Fiscal y la Gobernanza de la Superintendencia de Administración Tributaria (SAT), el cual incluye las disposiciones para limitar el secreto bancario. Asimismo, y en complementariedad a esta acción, el Directorio de la SAT aprobó a través del Acuerdo 09-2016 la creación de la Gerencia de Asuntos Internos, con el objeto de prevenir y combatir actos de corrupción, faltas e infracciones administrativas; así como cualquier otro acto que contravenga los intereses institucionales.
- Mediante Decreto No. 9-2015, el Congreso de la República de Guatemala aprobó reformas a la Ley de Contrataciones del Estado, con el propósito de fortalecer y normar los procedimientos que deben cumplirse para aumentar la transparencia y reducir la discrecionalidad en los procedimientos de contratación. Asimismo se emitió el Acuerdo Gubernativo No. 122-2016, el cual acordó emitir el Reglamento de la Ley de Contrataciones del Estado cuyo objetivo es regular, desarrollar y facilitar la aplicación de las normas contenidas en dicha ley, incluyendo los procedimientos de contratación para los fideicomisos públicos.
- Se emitió el Acuerdo Gubernativo No. 180-2016, por medio del cual el Gobierno de la República: a) autoriza la realización de un Censo de Trabajadores Públicos; y, b) ordena el uso del Sistema Integrado de Recursos Humanos y de Guatenóminas por el Gobierno, con el fin de mejorar los controles de nómina de los empleados del Sector Público.
- La Superintendencia de Bancos fortaleció la supervisión de las transacciones financieras de clientes de alto riesgo, incluyendo las transacciones significativas con entidades del sector público al ordenar que: a) las instituciones financieras lleven a cabo una mejor diligencia de las relaciones comerciales con los contratistas del Estado, incluidas sus cuentas bancarias; y, b) todas las entidades reguladas cumplan con los procedimientos para la gestión y tratamiento de los riesgos relacionados con el lavado de dinero y el financiamiento del terrorismo, todo ello de conformidad con el Decreto No. 67-2001 del Congreso de la República de Guatemala, y sus enmiendas.

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- Se emitió el Decreto No. 18-2016 por medio del cual se aprueban las reformas a la Ley Orgánica del Ministerio Público, Decreto No. 40-94 del Congreso de la República, con el propósito de regular e institucionalizar de manera integral el servicio civil y la carrera del Ministerio Público a nivel fiscal, técnico y administrativo y el régimen disciplinario y sus órganos respectivos.

Asimismo, según el Artículo No. 64 del Decreto citado, se crearon las juntas disciplinarias, las que tendrán a su cargo conocer y en su caso, imponer las sanciones por faltas leves, graves y muy graves, de conformidad con la presente Ley a fiscales regionales, fiscales de distrito, fiscales de distrito adjunto, fiscales de sección, fiscales de sección adjunto, agentes fiscales, fiscales para asuntos especiales, auxiliares fiscales, oficiales de fiscalía y personal de la Dirección de Investigaciones Criminalísticas, y se creó una Junta Disciplinaria que está funcionando.

Como se puede observar, el Gobierno de la República de Guatemala está altamente comprometido con la promoción e implementación de las acciones necesarias para alcanzar un mayor crecimiento económico sostenido, un incremento en la inversión productiva, priorizada en las áreas de salud y protección social, así como, el fortalecimiento de la transparencia y eficiencia en la gestión del gasto público, todo ello con el propósito de aumentar el desarrollo económico del país y mejorar la calidad de vida de la población guatemalteca, en especial de los grupos más vulnerables.

Es en este contexto, el apoyo financiero del Banco Mundial a través del Primer Préstamo de Políticas de Desarrollo para la Mejora de la Gobernanza de los Recursos Públicos y Nutrición por US\$250.0 millones cobra particular relevancia, y se enmarca dentro de la estrategia de financiamiento del Presupuesto General de la Nación, razón por la cual agradeceremos sus buenos oficios, a efecto de continuar con las gestiones internas en el Banco que permitan su aprobación.

Por lo anterior, queda sin efecto el oficio No. 002491, enviado con ese mismo propósito.

Al agradecer el continuo apoyo que nos brinda el Banco Mundial, aprovecho la oportunidad para expresarle las muestras de mi consideración y estima, deferentemente,

DCH/ROG/MS/EME


Julio Héctor Estrada
MINISTRO DE FINANZAS PUBLICAS



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LETTER OF DEVELOPMENT POLICY
UNOFFICIAL TRANSLATION
MINISTRY OF PUBLIC FINANCE
GUATEMALA

October 12, 2016

Doctor
Jim Yong Kim
President of the World Bank Group
Washington D.C., USA

Mr. President:

The Government, led by Mr. Jimmy Morales, designed its Government Plan 2016-2020, with a focus on improving the living standards of Guatemalans and reducing poverty through results-oriented, effective Public Management that is monitored and evaluated continuously, by implementing policies that encourage efficient provision of basic education, health, and nutrition. To that end, the Government is implementing a Plan based on two main themes: participatory democracy and territorial management, which includes five areas: Transparency, Health, Education, Economic Development and Public Safety.

Based on these five areas, twelve priorities have been developed to set the course of the current Government Administration: i) Transparency: Open and transparent Government; ii) Health: Timely provision of Conventional and Alternative Medicines and Reduction of Chronic Malnutrition (10%); iii) Education: Alternative Education Schooling and Technology in the Classroom; iv) Economic Development: New Businesses, Tourism Promotion, Infrastructure and Fiscal Sustainability; and v) Public Safety: Border Control, Violence Prevention and Justice Sector Support.

The assistance strategy under discussion with the World Bank provides, among other things, for accompanying and supporting the implementation of the Government's Plan, through two Programmatic Development Policy Loans. The objective of these operations is to create fiscal space and expand opportunities for the most vulnerable segments of society. To this end, support will be given to two key policy areas: i) enhance the policy and institutional framework to address primary health care deficiencies and chronic malnutrition; and (ii) strengthen the regulatory and institutional framework to improve governance of public resources and accountability.

In this regard, the first operation called, First Programmatic Improved Governance of Public Resources and Nutrition Development Policy Loan, provides budgetary support to the financing needs of the State. On that account, the overall objective of the Program is to support the Government's efforts to: i) enhance the policy and institutional framework to address primary health care deficiencies and chronic malnutrition; and (ii) strengthen the regulatory and institutional framework to improve governance of public resources and accountability.

Based on the above, and in context with the commitment of the Government of the Republic of Guatemala, the following measures have been taken:

1. *Enhancing the policy and institutional framework to address primary health care deficiencies and chronic malnutrition:* The Government of Guatemala is committed to continue strengthening budgetary processes to increase the efficiency and effectiveness of public institutions, to meet current and future demand for public services without neglecting demand from the most vulnerable groups (safeguarding social budget) and, on the other hand, boost investments focusing on priority programs and projects.

To this end, the following measures have been implemented:

- Ministerial Decree No. 261-2016, issued by the Ministry of Public Health and Social Assistance, through which it was agreed to define and implement the Inclusive Health Model (MIS), which aims to contribute to the transformation of the healthcare system from the proposed basis and guidelines for an inclusive primary health care, based on the right to healthcare, with multiculturalism relevance, gender perspective, and optimal attributes as the foundation of the public health system in Guatemala.

The MIS is based on three perspectives, namely: the right to health, gender perspective and multiculturalism. It develops an operational programmatic strategy that integrates the standards of healthcare and health monitoring of the Ministry of Public Health and Social Assistance (MSPAS), and consists of the following three health programs:

1) Individual, aimed at curative and preventive care; 2) Family, focused on preventive care at the family level; and 3) Community, based on health promotion.

- Executive Decree No. 45-2016 through which the Presidential Commission for the Reduction of Chronic Malnutrition, which facilitates and promotes the mechanisms of prevention and treatment of chronic malnutrition for human development and for improving the quality of life of children under five years of age. Furthermore, the Strategy for the Prevention of Chronic Malnutrition was adopted in the Second Session of the National Council for Food and Nutritional Security (CONASAN), as stated in the Third item of the Number Zero Two – Two Thousand Sixteen (02-2016) Act of that session.
- Ministerial Decree No. DS 42-2016 of the Ministry of Social Development through which the document Geographic Targeting of Programs and Projects of the Ministry was adopted, which will serve as an aid to streamline the implementation of social programs.
- Ministerial Decree No. DS-24-2016 of the Ministry of Social Development through which the Ministerial Decree of the Social Program "Mi Bolsa Segura " is amended, for the purposes of adding the conditional cash transfer for Foods to that Program, as a social protection mechanism creating conditions for food assistance and access to basic food basket products for families living in poverty and extreme poverty. In addition, the DS- Ministerial Decree No. 26-2016 through defining the Operating Manual which contains the operating rules of the said intervention.

2. ***Strengthening the regulatory and institutional framework to improve governance of public resources and accountability:*** A key objective of the Government Program is maintaining disciplined and orderly public finances, which in turn contribute to development and reducing poverty in the country, and do not jeopardize macroeconomic stability with high and unsustainable fiscal deficits. In addition, there is interest in improving tax administration, procurement processes and transparency in the financial sector in Guatemala, through policy measures aimed at increasing tax revenues and strengthening prevention of money laundering.

To this end, the following measures have been adopted:

- The Law for Strengthening Fiscal Transparency and Governance of Tax Administration (SAT) - Law No. 37-2016 – approved by the Congress includes provisions to limit bank secrecy. In addition, and complementing this action, the SAT's Board of Directors approved, through Board Resolution 09-2016, the creation of the Internal Affairs unit, in order to prevent and combat corruption, errors and administrative infractions, and any other act that contravenes the institutional interests.
- Through the Law No. 9-2015, the Congress of Guatemala approved amendments to the Public Procurement Code, in order to strengthen and standardize the procedures that must be met to increase transparency and reduce discretion in procurement procedures. Likewise, the Executive Decrees No. 122-2016 was issued, which approved the issuance of Law Regulations on Government Procurement issued aimed to regulate, develop and facilitate the implementation of the rules contained in the Act, including recruitment procedures for public trusts.
- Executive Decree No. 180-2016 was issued, by which the Government of the Republic authorizes a public sector workforce census, and mandates the use of the Integrated Human Resources System and of Guatenóminas by the Government, in order to improve public sector payroll controls.
- The Superintendence of Banks strengthened its supervision of financial transactions of high risk clients, including significant transactions with public sector entities by mandating that: (a) financial institutions carry out enhanced due diligence of business relationships with State Contractors, including bank accounts; and (b) all Regulated Entities to comply with procedures for managing and addressing the risks related to money laundering and financing of terrorism, all in accordance with Legislative Decree No. 67-2001 of the Congress of Guatemala, and its amendments to date, as evidenced by Special Verification Intendent's letter No. 3654-2016 dated September 30, 2016.
- Legislative Decree No. 18-2016 was issued whereby amendments to the Organic Law of the Public Ministry Law No. 40-94 of the Congress of the Republic were approved, in order to regulate and institutionalize the civil service and the Public Ministry profession at the fiscal, technical and administrative levels and the disciplinary system and their respective bodies.

Furthermore, according to the Article No. 64 of the Law, the disciplinary boards were established, and will be responsible for investigating and where appropriate, imposing penalties

for minor, serious and very serious offenses, in accordance with the present law to regional prosecutors, district attorneys, deputy district prosecutors, section prosecutors, tax agents, special affairs prosecutors, assistant prosecutors, fiscal officers and staff of the Criminal Investigations Directorate, and a Disciplinary Commission was created and is functioning.

As shown, the Government of the Republic of Guatemala is highly committed to the promotion and implementation of the necessary measures to achieve greater sustained economic growth, an increase in productive investments, prioritized in the areas of health and social protection, as well as strengthening transparency and efficiency in public expenditure management, all with the aim of increasing the country's economic development and improving the quality of life of the Guatemalan population, especially the most vulnerable groups.

It is in this context that the financial support from the World Bank through the First Improved Governance of Public Resources and Nutrition Development Policy Loan for US\$250 million is particularly relevant, and it is part of the financing strategy of the General National Budget, and therefore we would appreciate your collaboration to continue processing the operation to seek the Bank's approval.

Upon thanking the continuous support given by the World Bank, I take this opportunity to express the assurances of my consideration and esteem, respectfully,

ANNEX 3: IMF RELATIONS ANNEX

On August 22, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Guatemala, and considered and endorsed the staff appraisal without a meeting.

The Guatemalan economy withstood the 2015 political crisis well. A solid policy track record together with favorable external conditions contributed to the resilience. The new administration, who took office in January, 2016, is undertaking important efforts to tackle corruption, one of the major challenges facing the country's economy and society at large. The main strands of these efforts include a broad-based reform of the tax and customs administration, more transparent public procurement, increased accountability of Congress, a more independent Judiciary, and stricter application of the rule of law.

Macroeconomic performance has been solid. The economy grew at 4.1 percent in 2015, slightly above potential, despite a slowdown in public consumption and investment during the crisis. Private consumption was lifted by lower oil prices and strong remittances. The latter also boosted the external position, creating a comfortable reserve cushion. With inflation well-anchored, monetary policy was eased to support growth. The financial system remained stable with no material loss of correspondent banking relationships. Fiscal revenues, however, fell well below expectations. The shortfall was offset by even larger spending cuts, resulting in a fiscal deficit below the budget target.

Progress on social objectives is lagging. Only one fourth of the Millennium Development Goals (MDGs) for 2015 were met, with none met for the rural and indigenous population. Moreover, there have been reversals in reducing extreme poverty and raising school enrollment.

The macroeconomic outlook remains benign. Growth is set to return to its trend rate of 3.8 percent in 2016 and gradually rise to 4 percent in the medium-term, reflecting the positive impact of efforts to increase transparency and efficiency of public spending. Despite a pick-up in food price inflation, headline inflation has remained within the target range so far in 2016 and is expected to stay on course in the medium-term. The external position is set to widen to 1.7 percent of GDP by 2021, driven by gradual reversal of the oil price decline and strong domestic demand. Fiscal deficit is projected to remain close to 1.5 percent of GDP in the medium-term. Risks, however, are tilted towards the downside due to global uncertainties and domestic policy constraints.

Executive Board Assessment

The economy weathered the 2015 political crisis well. Despite the impact of revenue shortfalls on public expenditure, growth remained robust in 2015, supported by low oil prices and strong remittances. The exchange rate has been stable and inflation has remained within the central bank's target range. These trends are expected to continue in the medium-term, with GDP growing at potential and inflation within the target range. The current account deficit is projected to increase only gradually. However, there are downside risks to growth from global uncertainties and domestic policy constraints.

A higher fiscal deficit could be justified on structural and social grounds. With the output gap closed, the current broadly neutral fiscal stance is reasonable. However, a fiscal relaxation to bring the overall deficit to around 2 percent of GDP may be justified to maintain capital and social spending and to implement the

anti-corruption reform agenda. However, this should be a temporary increase in the deficit while efforts to raise the revenue-GDP ratio are put in place.

Monetary policy should be attuned to signs of an increase in inflation. Core inflation remains below the target range, inflation expectations well-anchored, and inflation is forecasted to remain within the target range. However, the central bank should stand ready to increase the policy rate promptly if inflationary pressures intensify.

Structural objectives should guide fiscal policy over the medium-term. A gradual increase in fiscal revenues to at least 15 percent of GDP would be essential to meet critical social, security and infrastructure needs and to support long-term growth. This will require both improvements in tax administration and a revamp of the tax policy framework, including through an increase in tax rates. Tax reform should be presented in the context of a more comprehensive reform strategy to help secure public support. Measures to improve fiscal transparency and efficiency on the expenditure side would help raise government credibility.

The central bank should transition to a full-fledged inflation targeting. Additional measures to strengthen the monetary transmission, including continuing efforts to increase exchange rate flexibility, discourage dollarization, cover past and current operational losses of the Central Bank in the short term and recapitalize the Central Bank in the longer term, and develop capital markets would help with that transition.

Guatemala's external position is moderately stronger than the level consistent with medium-term fundamentals and desirable policy settings. A lower-than-desirable fiscal deficit accounts for most of the identified policy gap. Reducing crime and corruption, investing in education and infrastructure, strengthening legal protection, and deepening the financial system would help mitigate the competitiveness gap.

Efforts to fortify the financial system should continue. The financial system appears sound, though moderately high credit dollarization, fast growing foreign bank liabilities, and exposure to sovereign debt represent vulnerabilities. The system has not been materially affected by the loss of correspondent banking relationships. However, this should not slow efforts to strengthen risk-based Anti-Money Laundering/Combating the Financing of Terrorism supervision and bring the framework into line with the Financial Action Task Force standards, especially as it would complement efforts to combat crime and corruption. Continued implementation of the 2014 Financial Sector Assessment Program update and regional cluster surveillance report recommendations, including strengthening capital and liquidity buffers as well as enhancing consolidated supervision of financial conglomerates, will help strengthen financial system's resilience.

Structural reforms should support higher and more inclusive growth. Increasing the size and efficiency of social assistance programs as well as raising public expenditures on education, infrastructure, and security will be important to continue building human and physical capital. Improved childcare and support to indigenous women could help raise female labor force participation. Continued progress on regional and international integration, stronger competition policies, and measures to support financial deepening and inclusion, will also help stimulate long-term inclusive growth. Articulating an overarching long-term growth and social strategy would help garner public support for the reforms.

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior actions	Significant positive or negative environment effects (yes/no/to be determined)	Significant poverty, social or distributional effects positive or negative (yes/no/to be determined)
<i>Pillar 1: Enhancing the policy and institutional framework to address primary health care deficiencies and chronic malnutrition</i>		
<p>Prior action 1: A Ministerial Decree (<i>Acuerdo Ministerial</i>) is approved creating the new primary health care model, including the expansion of an essential package of nutrition and health services.</p>	<p>No significant negative or positive effects on the environment.</p>	<p>Positive poverty and social effects. The effects of an improvement in primary health care provision in the poorest departments and with the highest malnutrition rates are expected to be positive.</p>
<p>Prior action 2: The framework to set policies to reduce malnutrition is established through (a) Executive Decree (<i>Acuerdo Gubernativo</i>) creating the Presidential Commission for the Reduction of Chronic Malnutrition; and (b) a Resolution of CONASAN approving the strategy to reduce chronic malnutrition and prioritizing the seven neediest sub-national jurisdictions (departments) for its implementation.</p>	<p>No significant negative or positive effects on the environment.</p>	<p>Positive poverty and social effects on the most vulnerable. It is expected that a framework to set policies to reduce malnutrition will have positive effects in the medium-term, as preventing/treating malnutrition decreases incidence of non-communicable diseases, improves immunity, and increases learning potential and work productivity.</p>
<p>Prior action 3: A Ministerial Decree (<i>Acuerdo Ministerial</i>) is approved adopting a Geographical Targeting Methodology for MIDES programs and projects with a view to enhance targeting to the poor and efficiency of social spending.</p>	<p>No significant negative or positive effects on the environment.</p>	<p>Positive poverty and social effects. Geographical targeting is expected to have significant impact on both poverty and social outcomes such as health and education.</p>
<p>Prior action 4: A Ministerial Decree (<i>Acuerdo Ministerial</i>) is issued to restructure the Food-CCT (<i>Transferencia</i></p>	<p>No significant negative or positive effects on the environment.</p>	<p>Positive poverty and social effects. It is expected that the prioritization to the poorest and the regularity of transfers of the</p>

<p><i>Monetaria Condicionada para Alimentos</i>) by replacing the in-kind transfer with a periodic conditional transfer that is: (i) targeted better to poor and extreme poor households enrolled on the basis of socioeconomic indicators, (ii) provided through a debit card to be used in pre-identified food establishments, and (iii) geo-referenced to beneficiary household data.</p>		<p>CCT program will have positive effect on the poor.</p>
<p><i>Pillar 2: Strengthening the regulatory and institutional framework to improve governance of public resources and accountability</i></p>		
<p>Prior action 5: Amendments to the organic Law of the Tax Administration Superintendence (SAT) and related Laws, including provisions to limit bank secrecy embedded in these related Laws, are enacted to improve governance of the SAT and enhance tax collection compliance.</p>	<p>No significant negative effects on the environment.</p> <p>Enforcement of VAT and import duties of products typically associated with environment degradation (e.g. fuels,) could potentially contribute to positive effects.</p>	<p>No significant poverty/social effects. Increase in tax collection is expected to benefit the population as a whole.</p>
<p>Prior action 6: Establishment of an internal affairs/investigation unit in the SAT, with a view to strengthen internal accountability.</p>	<p>No significant negative or positive effects on the environment.</p>	<p>No significant poverty/social effects. Improvement in the internal governance of SAT is expected to reduce opportunities for corruption and lead, in the future, to greater revenue collection.</p>
<p>Prior action 7: Amendments to the Procurement Code (<i>Ley de Contrataciones del Estado</i>) are enacted, and corresponding regulations are issued, with a view to increase competition and limit discretion in procurement procedures, including procurement procedures for public trusts (<i>fideicomisos</i>).</p>	<p>No significant negative or positive effects on the environment.</p>	<p>No significant poverty/social effects. Increase in transparency and competition of procurement processes is expected to contribute to fiscal savings and benefit the population as a whole, including the poor.</p>

<p>Prior action 8: For purposes of enhancing payroll controls of public sector employees, the government mandated: (a) the carrying out of a public sector workforce census, and (b) the use of the integrated system of human resources and of the unified payroll system (<i>Guatenóminas</i>), as evidenced by Executive Decree No. 180-2016, dated September 21, 2016.</p>	<p>No significant negative or positive effects on the environment.</p>	<p>No significant poverty/social effects. The action of mandating the census will not have poverty/social effects. However, it is intended that this reform will lead to an update of the payroll (trigger), which could potentially lead to a decline in public sector payroll, as the Census might identify irregularities in payroll. A poverty and social impact analysis will be conducted in the context of DPF2. However, given that only 2.1 percent of the poor are employed in the public sector such reform is not expected to have significant poverty and social effects.</p>
<p>Prior action 9: The Superintendence of Banks has strengthened its supervision of financial transactions of High Risk Clients, including significant transactions with Public Sector Entities, by mandating:</p> <p>(a) financial institutions to carry out enhanced due diligence of business relationships with State Contractors, including bank accounts;</p> <p>(b) all Regulated Entities to comply with procedures for managing and addressing the risks related to money laundering and financing of terrorism, all pursuant to the Borrower’s Law No. 67-2001, as amended to the date of this Agreement, and as evidenced by the Special Verification Intendent’s letter No. 3654-2016 dated September 30, 2016.</p>	<p>No significant negative or positive effects on the environment.</p>	<p>No significant poverty/social effects.</p>

Prior action 10: Amendments to the Public Prosecution Law are enacted with a view to strengthen the independence and capacity of the Public Ministry to combat corruption; and a Disciplinary Commission is created (<i>Junta Disciplinaria</i>).	No significant negative effects on the environment.	No significant poverty/social effects.
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ANNEX 5: MULTI-ANNUAL BUDGET, FUNCTIONAL CLASSIFICATION

Budget allocations, share of budget	2016	2017	2018	2019	2020	2021
Presidency of the Republic	0.3	0.3	0.3	0.3	0.2	0.2
Ministry of Foreign Relations	0.6	0.6	0.5	0.5	0.5	0.5
Ministry of Interior	6.3	6.7	6.5	6.4	6.4	6.4
Ministry of National Defense	2.9	2.6	2.8	2.8	2.8	2.8
Ministry of Public Finances	0.4	0.5	0.5	0.5	0.5	0.5
Ministry of Education	18.2	17.4	17.4	17.2	17.1	17.3
Ministry of Public Health and Social Assistance	7.8	8.5	8.8	8.7	8.5	8.8
Ministry of Labor	0.9	0.8	0.8	0.8	0.7	0.7
Ministry of Economy	0.4	0.8	0.5	0.3	0.3	0.3
Ministry of Agriculture, Cattle Raising, and Food	1.8	1.7	1.6	1.4	1.4	1.4
Ministry of Communications, Infrastructure, and Housing	5.1	6.9	6.8	7.0	7.3	7.2
Ministry of Energy and Mining	0.1	0.1	0.1	0.1	0.1	0.1
Ministry of Culture and Sport	0.6	0.7	0.7	0.7	0.7	0.7
Secretariats and other Executive agencies	1.6	1.7	1.6	1.6	1.6	1.5
Ministry of Environment and Natural Resources	0.2	0.2	0.2	0.2	0.2	0.2
State Obligations in charge of Treasury*	33.6	32.6	32.3	32.5	32.1	31.7
Public Debt Service	17.6	16.2	17.2	17.5	18.1	18.0
Ministry of Social Development	1.4	1.5	1.3	1.4	1.4	1.7
General Attorney's Office	0.1	0.1	0.1	0.1	0.1	0.1

* Includes Municipalities, CODEDES, Congress, USAC, SAT.