Report Number : ICRR0020237

1. Project Data

Operation ID	Operation Name
P131763	GT First Programmatic DPL (P131763)
Country	**Practice Area(Lead)**
Guatemala	Macro Economics & Fiscal Management

Programmatic DPL

Planned Operations: 2 Approved Operations: 2

L/C/TF Number(s)	Closing Date (Original)	Total Financing (USD)
IBRD-82030	31-Dec-2013	200,000,000.00
Bank Approval Date	**Closing Date (Actual)**	
27-Sep-2012	31-Dec-2013	

	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	200,000,000.00	0.00
Revised Commitment	200,000,000.00	0.00
Actual	200,000,000.00	0.00

Sector(s)
Central government administration(58%):Health(25%):Other social services(17%)

Theme(s)
Public expenditure, financial management and procurement(5%):Tax policy and administration(50%):Participation and civic engagement(17%):Nutrition and food security(14%):Population and reproductive health(14%)

Prepared by	Reviewed by	ICR Review Coordinator	Group
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Operation ID	Operation Name
P133738	GT 2nd Prog DPL Fiscal Space
Country	**Practice Area(Lead)**
Guatemala	Macro Economics & Fiscal Management

Public Disclosure Authorized

L/C/TF Number(s)	Closing Date (Original)	Total Financing (USD)
IBRD-82030,IBRD-83850	31-Mar-2015	340,000,000.00
Bank Approval Date	**Closing Date (Actual)**	
17-Jun-2014	31-Mar-2015	

	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	340,000,000.00	0.00
Revised Commitment	340,000,000.00	0.00
Actual	340,000,000.00	0.00

Sector(s)
Central government administration(71%):Other social services(29%)

Theme(s)
Tax policy and administration(43%):Public expenditure, financial management and procurement(29%):Social Protection and Labor Policy & Systems(14%):Nutrition and food security(14%)

2. Project Objectives and Policy Areas

a. Objectives

The Program Document (PD) for the first DPO (DPO1) of the series articulated the objective as follows" "to support the Guatemalan Government in creating fiscal space and expanding opportunities for the most vulnerable segments of society." The PD for the second DPO of the series (DPO2) articulated the Program Development Objective as follows: "to support the Government of Guatemala to (i) strengthen tax administration and tax policy; (ii) strengthen budget management and increase the results orientation of public spending; and (iii) improve the management and coordination of social policies." This Review assesses efficacy on the basis of the three objectives articulated in the DPO2.

b. Were the program objectives/key associated outcome targets revised during implementation of the series? If yes, were the changes part of the program document approved by the Board?
No

c. Pillars/Policy Areas

The DPOs supported three policy areas (PD DPL1, p. 19-28; PD DPL2, p.11-24):
1. **Tax Administration and Policy.** This policy areas supports a package of reforms to improve tax revenues, including elimination of tax credits on Value Added Tax Payments to small businesses, a simplified flat rate for small taxpayers, simplified tax rates for salaried workers, increased vehicle tax rates, use of bank-based transactions for tax enforcement purposes, alignment of customs sanctions to the regional Central American Customs Code, information [LNP1] sharing agreements with other countries, transfer pricing on transactions between related parties, and a new organizational structure of the Tax Administration Superintendent.

2. **Public Expenditure Quality.** This area included (i) introduction of results-based expenditure management, and (ii) mandates to use the

Single Treasury Account to process budget transactions; report activities executed with public funds to the Ministry of Finance; and use the Integrated Financial Management System to consolidate budgetary and financial information.

3. **Social Policy**. This area included (i) the creation of the Ministry of Social Development, establishment of a social information system at this Ministry, and creation of the Economic and Social Council (to strengthen stakeholder participation in economic and social policy making); and (ii) adoption of a Zero Hunger Plan to reduce child malnutrition and mortality, combat hunger, and promote food and nutrition security with creation of Municipal Councils of Food and Nutrition Security to coordinate nutrition actions at the local level.

d. Comments on Program Cost, Financing, and Dates

The program consisted of two Development Policy Operations. The first, for $200 million, was approved in September 27, 2012, declared effective on November 21, 2013, and closed as planned on December 31, 2013. The second, in the amount of $340 million, was approved on June 17, 2014, declared effective on February 26, 2015 and closed as planned on March 31, 2015. The DPLs were fully disbursed upon effectiveness. Delays in effectiveness are due to the requirement that each individual loan be approved by Parliament.

3. Relevance of Objectives & Design

a. Relevance of Objectives

The objectives were relevant to country conditions, including Guatemala's (i) low tax-to-GDP ratio (10.8 percent in 2012), which is below the Central American average (13.3 percent) and well below the Latin American average (19.2 percent), and an old tax law that had ambiguities and facilitated evasion; (ii) weak links between budgeting and policy objectives, as well as broader weaknesses in budget management, including an information system that does not allow incorporation of ministries' plans into the budget; and (iii) fragmentation of social policy across different agencies, government levels, and multiple programs. The first two DPO objectives (on taxes and public expenditure) were relevant to the Government's "Fiscal Pact" program of tax and expenditure reforms, and the third DPO objective (social policies) was broadly relevant to the Government's "social inclusion" objective. The objectives were also relevant to the Bank's Country Assistance Strategy for 2013-16, submitted to the Board at the same time as DPO1, and which sought to create fiscal space, enhance budget transparency, and improve results in the social sectors.

Rating
Substantial

b. Relevance of Design

Measures in the three reform areas could be expected to contribute to the objectives. On taxes, for example, use of bank-based transactions as an income tax enforcement tool, reduced eligibility of VAT tax credits, the simplified flat rate tax regime for small taxpayers, international tax information sharing agreements, transfer pricing between related parties, and a stronger capacity and information technology of the tax agency may help improve income tax administration. Adoption of the common Central American Customs Code and an information exchange agreement with the USA on import and export values may help improve administration of custom revenues. Simplification of tax rates is a good tax policy practice. Increased vehicle registration and user tax rates can be expected to raise tax collections. A DPO series was an appropriate instrument, as reforms take time to be implemented and to yield results.

However, long-standing governance problems impair the tax collection effort in Guatemala. Past experience, both in Guatemala and elsewhere, has demonstrated that, unless and until these problems are addressed, technical and institutional reforms, such as those supported by the DPOs under review, would have only a limited impact. Program design contains no significant activities related to this issue. The objectives are, moreover, imprecisely formulated in several respects. Strengthening tax policy may cover different dimensions (revenue collection, progressivity, economic efficiency); the Government's program strongly suggests that the objective in this regard was primarily to raise tax collections. Similarly, stronger budget management, the first part of the second objective, may cover multiple dimensions (fiscal, operational, and fiduciary risk management, as well as governance). It is unclear what this part of the second objective was intended to achieve. The results indicators only refer to the results orientation dimension of this second objective. Similarly, the third objective – management and coordination of

social policies – could cover assurance of regular flows of resources, internal processes, targeting, synergies across programs, and monitoring and evaluation. The prior actions and results indicators in this area could be aimed at any of these dimensions.

The macroeconomic framework at the time of preparation and approval of DPO1 was satisfactory. Growth had been robust, and as domestic demand pressures weakened, inflation fell sharply in 2012 to 3.4% compared to 6.25% in 2011. The current account deficit declined to just below 3 percent of Gross Domestic Product (GDP) in 2012, from almost 3.5 percent in 2011. Net international reserves were in line with reserve adequacy metrics. The central government's deficit continued to narrow in 2012 to just below 2½ percent of GDP, but not enough to prevent a further rise in the ratio of public debt to GDP to 24 percent, comparatively manageable but a significant burden for government finances, given the low level of revenues. The framework remained satisfactory for the preparation and approval of DPO2 in mid-2014. Near-term policies were broadly appropriate. Inflation was at the bottom of the target range. Though the debt-to-GDP ratio remained moderate, debt stabilization required moderate tightening of the budgetary stance, with the emphasis on revenue mobilization.

Rating
Modest

4. Achievement of Objectives (Efficacy)

Objective 1

Objective
Objective 1: Strengthen tax administration and tax policy.

Rationale
The overall tax-to-GDP ratio, which remained at best stable (shy of 11.0 percent of GDP) suggests that overall improvements may have been negligible. However, the target to increase the income tax-to-GDP ratio from 2.7 percent in 2011 to 3.2 percent in 2014 was nearly achieved at 3.1 percent, possibly due to the combination of changes in income tax rules and enforcement efforts. In particular, another target – to increase the tax base (number of effective tax payers making direct payments to the Tax Administration Office) by at least 10 percent from 2011 to 2014 – was surpassed at 15 percent in 2014 and 18 percent in 2015 and may reflect some success in increasing the tax base and containing tax evaders. Nevertheless, the indirect tax-to-GDP ratio declined from 7.4 percent of GDP in 2011 to 6.9 percent in 2014, suggesting that the indirect tax measures or their administration were ineffective, particularly on customs revenues (as the ICR argues), although the target to increase the amount of sanctions on customs offenses from 0 to 4 million quetzals was surpassed at 7.3 million quetzals in 2014 and 9.6 million quetzals in 2015. In sum, the evidence points to improvements in income tax compliance offset by a deterioration of indirect tax compliance, particularly on customs. The ICR's assessment is that weak governance continues to undermine tax collection efforts. The PDs did not provide an indicator – e.g., the ratio of tax collection to tax administration costs - that could provide a summary quantification of tax administration efficiency.

Two targets on international tax information exchange were surpassed but would yield income tax results only over the medium to long term. One – to increase the number of countries with which Guatemala signed tax related information exchange frameworks from zero in 2011 to 60 in 2014 - was surpassed at 94 tax jurisdictions. Another – to increase in the number of countries with which Guatemala is exchanging tax related information (in line with the Global Forum's standards of transparency and exchange of tax information) from zero in 2011 to 5 in 2014 – was surpassed, with eight bilateral tax information exchange agreements signed, albeit awaiting ratification by Guatemala's Congress.

Regarding the strengthening of tax policy, the Government's program strongly suggests that the principal aim was to raise tax collection. As indicated above, the overall tax-to-GDP ratio did not improve. On other possible dimensions of tax policy, such as reduced exemptions and simplified tax rates, the PDs and the ICR do not provide sufficient comparative information or analysis to assess fully overall improvements.

Rating

Modest

Objective 2

Objective
Objective 2: Strengthen budget management and increase the results orientation of public spending.

Rationale
The PDs did not specify an indicator or target that could gauge progress in budget management (e.g., Public Expenditure and Financial Management Assessment [PEFA]) ratings at the beginning and end of the program), and the ICR does not provide an analysis of progress in its different dimensions (e.g., fiscal, operational, and fiduciary risk management, and governance). Nevertheless, the task team provided evidence that budget management improved. The Inter-American Development Bank's "Management for Development Results (MfDR) index, which measures five dimensions of budget management, indicated progress in three of the five dimensions, including results based budgeting, public financial management, and sectoral management of goods and services. The progress was measured between 2007 and 2013 and some of it could be linked to prior actions implemented in 2013.
On results orientation, the target (to increase the percentage of the total budget under the results-based budgeting (RBB) framework from zero in 2011 to 9 percent in 2014) was surpassed (9.5 percent). The Results Based Budgeting (RBB) covers the Ministries of Finance, Economy, Health and Social Assistance, and Sports and Culture. Other than the extent to which ministries are being incorporated into RBB, the ICR does not provide details on the RBB framework or how it has worked through the budget cycle and process. The other target under this objective was to increase the percentage of children under 1 year old in 83 prioritized municipalities who receive the appropriate growth promotion package of services for their age, which include weight and height check-ups, from 37.5 percent in 2011 to 50 percent in 2014. It was also surpassed at "over 87 percent" (ICR, p. 18). The ICR further notes slight declines in chronic child malnutrition and child underweight between 2012 and 2013 in the Zero Hunger Pact (see Section 2.b) priority areas. Implementation of the Zero Hunger Pact was also part of the RBB efforts in the Health Ministry.

Rating
Substantial

Objective 3

Objective
Objective 3: Improve the management and coordination of social policies.

Rationale
The Government, with the support of the DPOs, developed basic tools to improve management and coordination of social policies. These include the creation of the Ministry of Social Development (a DPO1 prior action), now in charge of all social programs; implementation of the single registry of beneficiaries of all social programs, which expanded its coverage to 90 percent of beneficiaries, exceeding the 80 percent target; increase in the number of active Municipal Councils of Food and Nutrition (committees established to promote and coordinate nutritional security objectives at the local level), which expanded in coverage from 25 percent in 2011 to 100 percent of the population in 2015 (i.e., all municipalities), thereby exceeding the target of 90 percent (for 2014); and operation of the new Economic and Social Council, which meets on a monthly basis (thereby achieving the target of holding "regular meetings") to review and propose public policies and legislative initiatives, and raise awareness of economic and social issues. Nevertheless, there are no indications yet that these actions have improved the key social program management and coordination dimensions noted in the PDs, including assurance of regular flows of resources, internal processes, targeting, synergies across programs, and monitoring and evaluation (see PD DPO2, para 66).

Rating
Substantial

5. Outcome

The program development objectives were substantially relevant to Bank and Government strategy, and addressed country conditions. Relevance of design is rated modest. DPO-supported reforms could potentially contribute to the objectives, although the scope of the reforms was limited with respect to the breadth of the objectives, particularly on budget management and social policies. Furthermore, it is likely that the impact of the reforms will be limited in the absence of stronger measures to address the governance dimension than those which feature in design. The first objective is rated modest -- the operations may have improved some tax policies (reduced exemptions, simplification of tax rates), but strengthening tax administration remains a challenge, calling into question the relevance of tax rules, particularly on customs taxes. The overall revenue effort did not improve. Regarding the second objective, the Government has gradually introduced results-based budgeting in several ministries, and there are indications of improvements in overall budget management. This objective is rated substantial. The third objective is also rated substantial -- the Government took a number of important steps towards improvements in the management and coordination of social policies, although there is no evidence yet of improved outcomes resulting from these.

a. Outcome Rating
Moderately Satisfactory

6. Rationale for Risk to Development Outcome Rating

The main risk is that governance issues continue to undermine tax revenues, the focus of Objective 1, although recent mitigation efforts may help improve governance of those revenues. This risk extends to the other two objectives, as RBB and social policies hinge on adequate resources to reward performance and finance social expenditures, such as those under the Zero Hunger Pact. It also extends to the macroeconomic framework, where weaker tax revenues reduce fiscal space to undertake countercyclical policies in response to external and domestic shocks.

a. Risk to Development Outcome Rating
Substantial

7. Assessment of Bank Performance

a. Quality-at-Entry
The operation′s objectives addressed well-documented conditions of low tax revenues, poor budget management, and fragmented social policies. Its approach envisaged a synergetic set of policies and institutional arrangements aimed at improving tax regulations and administration, budgeting practices, and social programs, although in some areas these policies were not fully aligned to the breadth of the objectives as formulated and attention to governance issues with a bearing on tax administration was weak. The Bank had a considerable corpus of analytical work on the DPO policy areas, but it is unclear how such work impacted the program′s design. The macroeconomic framework for the operation was adequate, with a moderate growth outlook and only marginal expected increases in public debt, but somewhat stressed by low tax revenues, some weaknesses in the inflation targeting framework, some rigidity in exchange rate management, and modest financial sector risks.

The RBB approach and coordination of social policies was expected to have positive social and poverty impacts, such as a reduced incidence of malnutrition. The Central Bank′s foreign exchange control arrangements, external audit arrangements and clean audit opinions, and disbursement and resource use conditions underpinned adequate fiduciary arrangements for Bank disbursements. Coordination of implementation, including M&E, was well placed at the Ministry of Finance. The Bank coordinated well with the IADB on the latter′s $300 million parallel operation and with the IMF, where the DPO efforts on tax revenues were welcome contributions towards an adequate fiscal stance.

Although the risk of continued impairment of revenue collection due to governance issues was identified as a risk (which did, in fact, materialize), no convincing mitigating measures were incorporated into the program.

Quality-at-Entry Rating
Moderately Satisfactory

b. Quality of supervision

Bank supervision was conducted both through virtual meetings with Government officials and two mid-term supervision missions respectively following approval of DPO1 and prior to its closing date. It was supported by Bank technical assistance activities in the three reform areas. Supervision focused primarily on reform implementation and on progress with respect to outcome targets. The Bank filed two implementation supervision reports in December 2012 and July 2013. The reports record progress in the outcome indicators, with summary assessments of such progress, and with candor in indicating less than satisfactory outcome and implementation ratings as a result of delays in Congressional approval of DPL1 and risks that the tax reform legislation would not be passed.

The PD for DPL 2 provided a detailed account of progress in indicators and other dimensions of the reforms supported by the series. The PD for DPL2 also redefined objectives, making them more specific, albeit not sufficiently so (See Section 2.b). Attention to transition arrangements is reflected in the Government's request for continued DPL financing as part of the new Country Partnership Strategy, which materialized in a new DPO supporting similar objectives.

Quality of Supervision Rating
Satisfactory

Overall Bank Performance Rating
Moderately Satisfactory

8. Assessment of Borrower Performance

a. Government Performance

The Government's prior actions under the loan, including tax and expenditure reforms, the budget framework, and social policy institutions indicated government commitment to objectives, although this commitment faltered on tax administration, a key area where the Government's actions (particularly on customs governance) were insufficient. Inadequate attention to governance issues affected tax administration and exposes tax administration reforms to risks. The Government provided an adequate policy environment, including macroeconomic stability, and sectoral policies, except on customs management. Governance remained a challenge Otherwise, progress in reform implementation was adequate, although M&E suffered from some deficiencies (Section 9). The program benefited from broad Government consultations on tax reform, the Zero Hunger Pact, and the creation of the Economic and Social Council.

Government Performance Rating
Moderately Satisfactory

b. Implementing Agency Performance

Government as a whole was the implementing agency and there is therefore no separate assessment.

Implementing Agency Performance Rating

Overall Borrower Performance Rating
Moderately Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

M&E design focused on monitoring indicators, with no planning of evaluation activities. DPO1 established the tax-to-GDP ratio as an indicator of the first objective (tax administration and policy), a good first approximation to tax administration results, complemented by the number of effective tax payers. DPO2 replaced the tax-to GDP ratio to the income tax-to-GDP ratio, which only captures results on income tax collection efforts. It would have been more useful to have kept the broader measure, as tax administration covers both direct and indirect taxes, perhaps providing targets on both of its components, and complementing them with tax collection efficiency indicators, such as tax-collection-to-tax-administration cost ratios. The increase in the number of tax payers could have been better compared to prior rates of increase to isolate trend effects. Other indicators (customs sanctions, international information sharing agreements) for the first objective reflected reform measures, not outcomes.

Targets and indicators for the second objective (on budget management and results orientation of public spending) covered only its results orientation dimension**.** Monitoring of the broader budget management dimension would have benefited from an update of the 2009 PEFA at the conclusion of the project. In the absence of a PEFA or similar assessment, this dimension was left bereft of evidence. Such an assessment could have also provided a fuller account of progress on RBB.

Targets and indicators on the third objective (management and coordination of social policies) covered tools to improve management and coordination. Accordingly, these indicators and targets (e.g., implementation of the single registry of beneficiaries of all social programs) fell short of being indicators of outcomes (e.g., on assurance of regular flows of resources to social programs).

b. M&E Implementation

The Ministry of Public Finance led M&E implementation. Baseline and end data were collected for all indicators and the two supervision reports show progress in the indicators in September and December 2012. The ICR notes only one pitfall on data quality (outdated population data projections for the indicator on the percentage of children who receive the appropriate growth promotion package of services). The indicators were designed primarily for use in monitoring the DPOs. During implementation, as noted earlier, the tax-to-GDP ratio was replaced by the income tax-to-GDP ratio as an indicator for Objective 1. This replacement was inappropriate, as the tax reform covered both direct and indirect taxes as well as overall tax administration. Collection of a few indicators is likely to be sustained overtime. Specifically, tax-to-GDP ratios have been regularly reported since well before the DPO and the tax office is likely to continue monitoring the number of taxpayers.

c. M&E Utilization

M&E was used to monitor progress toward the targets as well as to conduct a number of activities to better understand the impact of reforms, including, for example, an analysis of the impact of tax reform, of the quality of tax administration, and of tax compliance. Reflecting the DPO′s M&E design, M&E findings measured some outcomes, including trends in tax collection and the results orientation of the budget. Otherwise, it focused largely on outputs, missing a broader measurement of budget management outcomes as well as outcomes indicating results from reforms on management and coordination of social policies. There were no changes in the project′s direction or outcomes that could be attributed to the M&E activities, except for the redefinition of objectives for DPL2.

M&E Quality Rating

Substantial

10. Other Issues

a. Environmental and Social Effects

There were no significant environmental effects expected from the DPO series. As indicated, the RBB approach and coordination of social policies were expected to have a positive social impact, particularly a reduced incidence of malnutrition.

b. Fiduciary Compliance

1 The ICR did not report any fiduciary issues.

c. Unintended impacts (Positive or Negative)
None reported.

d. Other
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11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Moderately Satisfactory	Moderately Satisfactory	---
Risk to Development Outcome	Substantial	Substantial	---
Bank Performance	Satisfactory	Moderately Satisfactory	The Bank did not provide sufficient attention to governance issues, which have a critical bearing on tax collection efforts.
Borrower Performance	Moderately Satisfactory	Moderately Satisfactory	---
Quality of ICR		Substantial	---

Note
When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

12. Lessons

IEG draws three lessons from the DPO series:

1. The success of tax policies will hinge on the adequacy and governance of tax administration. The DPO series envisaged reforms of tax rules and administration that may have helped success on income tax revenues. However, success is largely elusive, particularly on indirect taxes, as weak governance continuei to undermine implementation of policy reforms.

2. Monitoring and evaluation of an objective to improve budget management will be difficult if not underpinned by data such as that collected by a Public Expenditure and Financial Management Assessment (PEFA). As a result, the results from the changes in the budgetary framework could not be fully assessed.

3. The effectiveness of social expenditures would benefit from integration across social programs and across government levels. The DPO series focused only on programs, where the Zero Hunger Pact developed an institutional arrangement (the Municipal Councils of Food and

Nutrition) to implement a central government program at the local level. Integration across social programs, of which there are at least 75 in Guatemala, would be required to improve the effectiveness of social expenditures through means-tested targeting.

13. Assessment Recommended?

No

14. Comments on Quality of ICR

The ICR is informative, well-written and concise. It provides good information on context and macroeconomic trends. It could have been more analytical in its discussion of achievement of development objectives. The ICR reports accurately on program indicators, and provides a separate discussion of each under its assessment of outcomes. It would have benefited from a discussion of (i) how well the outcome indicators reflected objectives (e.g., is the income tax-to-GDP ratio a good indicator of tax policy or of tax administration?) and (ii) to what extent can progress towards objectives be attributed to reforms (e.g., did the international information exchange agreements play any role in reaching tax objectives?). The section on relevance of design could also have been more analytical by discussing specifically, for example, how the reforms could have been expected to improve tax administration and its outcomes, especially in the absence of concrete measures to address governance.

a. Quality of ICR Rating
   Substantial