1. Key development issues and rationale for Bank involvement

Key development issues. With a multiethnic population of 13 million and a per-capita GNI of US$2,610, Guatemala is the largest economy in Central America. Since the end of the civil war in 1996, Guatemala has made significant progress in completing reforms, contributing to broad-based economic growth. The fiscal deficit and public debt-to-GDP ratio are among the lowest in Latin America. Public institutions are stronger and poverty rates have declined. In the last decade, the economy has further diversified from its traditional agricultural base. Increased access to foreign markets through regional trade agreements has also assisted economic diversification. As a result, economic growth, which peaked at 6.3 percent in 2007, has been stable. Much of this stability can be attributed to prudent macroeconomic policies that have kept inflation and public debt manageable, while avoiding fiscal imbalances.

Despite these gains, poverty rates, inequality, and social indicators do not compare favorably with similar countries. Guatemala ranks among the bottom four Latin American countries in the overall human development index (UNDP 2007). Despite a decline in 5 percentage points, the poverty rate remains higher than in many countries (56.2 percent in 2000, declining to 51.0 percent by 2006). Extreme poverty, at about 16 percent, is concentrated in rural and indigenous regions. The Gini coefficient only improved slightly between 2000 and 2006, slipping from 55.0 percent to 53.7 percent (World Development Indicators 2009).

In addition, GDP growth fell from an impressive 6.3 percent in 2007 to approximately 3.3 percent in 2008 and a paltry 0.6 percent in 2009. This decline is due in part to the current worldwide economic slowdown and the private sector’s low levels of productivity and competitiveness and lack of integration. Improving the private sector’s productivity and access to new technology and increasing participation in local and global markets can have enormous and positive economy-wide consequences.

Rationale for Bank Involvement. The proposed operation is fully aligned with the Country Partnership Strategy (CPS) (Report #44772-GU) for FY09-FY12. The overarching objective of
the CPS is to provide Guatemala with demand-driven and focused assistance to achieve key
development goals. The Bank assistance will focus on three of the country’s development
priorities: (1) Enhancing Fundamentals (2) Promoting Sustainable Growth and Productivity, and
(3) Expanding Opportunities. The proposed operation is expected to contribute to the CPS’s
objective of promoting sustainable growth and productivity. The operation is expected to
contribute to the Expanding Opportunities pillar of the CPS by creating job opportunities for
vulnerable groups. The operation will also contribute to the mitigation of crime and violence,
recognized as serious economic and social problems with important economic and social costs
for SMEs and the tourism sector. The lack of economic opportunities has been identified as one
of the risk factors of this problem.

This operation will also continue the long engagement the Bank has had in the competitiveness
sector in Guatemala through the US$15.3 million stand-alone Competitiveness Project (Loan #
7044-GU), the US$30.0 million loan for the Rural Economic Development Project (PDER) and
studies on CAFTA, the Investment Climate (2003 and 2008) and DPLs on Broad Based Growth
(P094897) and Fiscal and Institutional Development I and II (P112312 and P114373).

2. Proposed objective(s)

The Project Development Objective (PDO) is to contribute to the growth of Small and Medium
Enterprises in selected value chains by enhancing their value added, the quality of their products
and processes, and their integration into the national and international markets.

3. Preliminary description

The proposed project would be a US$32.0 million Specific Investment Loan (SIL) over a five
year period. The project can be summarized as follows:

- **Component 1: Creating More Productive Value Chains**

Component 1 will improve SME competitiveness through the development and partial financing
of action plans for selected value chains in sectors identified in the Country Economic
Memorandum and a recent national study. The component will select one value chain each
from the tourism, agribusiness, and wood products sectors. The selection process will be
transparent and competitive, based on technical criteria that reflect economic, social, and
environmental feasibility. The action plans will employ a public-private partnership approach,
and encourage strong SME participation. Selected value chains will become eligible for
graduation after two years, at which time, a new round of selection will take place, as conditions
permit. Key stakeholders (SMEs, chambers and associations, MINECO and the Ministry of
Environment and Natural Resource, MARN, and indigenous organizations such as Foro Maya)
will validate the value chain selection and action plans.

Figure 1 describes the phases, results and project financing. Project financing will decline as
private sector financing increases and the value chain approaches graduation.

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1 Juan José Narciso, Ministry of Economy study, 2010
The component will promote *ex-ante* risk management tools and practices as an integral part of the action plans of the selected value chains to increase the sustainability of the productivity and income gains. For example, risk management activities for the agribusiness value chain include the use of disease resistant seeds, natural disaster preparedness through targeted infrastructure investments and insurance instruments, integrated pest management, index insurance for crops and animals, and price hedging for inputs.

Tourism. The project will work with a group of SMEs and other firms in the selected value chain and other stakeholders to develop several highly attractive tourism packages and address related physical, marketing, regulatory and other constraints identified by the value chain. Activities could include upgrading heritage sites, creating safe zones for targeted routes, training of guides, institutional strengthening of tourism organizations, introduction of clean production technologies in small hotels, creating a joint web site, and familiarization trips by international tour operators. The component will directly address security concerns, drawing lessons from the Tourist Assistance Program, Taxi Seguro, and international experience.

Agribusiness. The project will work with a group of SMEs and other firms in the selected value chain and other stakeholders to trigger productive private investments and job creation. Activities could include cold chain development, new product development, market intelligence activities, niche market development (organic or Fair Trade seals), and SME certification.

Wood products. The project will support interventions in the selected wood products value chain resulting in productive investments and job creation. The net environmental impact should be positive because it will promote the use of certified wood, improved cutting techniques (allowing more wood to be produced from each tree), and better drying techniques. Activities could include solar dry kilns and finger joint manufacturers, market intelligence, new product development and promotion, and vocational training. The project will not finance logging equipment. MARN,
Rainforest Alliance and other interested parties will review the proposals to insure that the action plans meet all Bank (OP 4.36) and national requirements.

- **Component 2 – Improving Business Climate and Support Services for SMEs**

This component will address specific public policy, institutional, and regulatory issues that impede value chain development and undermine an enabling business climate, especially for SMEs. The component will address (i) national policy issues including those identified by the Doing Business reform memo and the CEM, and (ii) specific policies encountered by the value chains supported by the project. The component will support dedicated MINECO staff to coordinate solutions to the problems with relevant public agencies and private actors, using expert technical assistance, training and equipment to overcome these productivity bottlenecks.

*Quality.* The component will strengthen the national quality infrastructure and ensure SME access to quality and certification services. Areas of concentration will include accreditation, metrology, technical regulations, and standards (including phytosanitary and sanitary standards), in coordination with other ministries. In addition, the Component will finance training activities and, on a declining basis, additional technical staff, particularly for the metrology lab. The project will also finance the capacity building (training, equipment) needed to increase the coverage of the accreditation services. The Component will strengthen the information platform of the national quality system, expanding online information on standards and providing a directory of certified firms and accredited labs. As value chains identify specific quality barriers to growth and productivity, the component will add these to the reform work plan.

*Business Climate Reforms and Policies.* Component 2 will also finance the work identified by the IFC’s Doing Business team in the Reform memo (September 2008). This includes taxation and business administration issues that significantly affect SMEs. Since many SMEs are informal, the component will support reforms related to starting a business and closing a business. Beyond the Doing Business measures, other burdensome business regulations and taxes will be identified through the value chain diagnostics. The component will also fund the digitization of the Commercial Registry and promote the harmonization of tax and social security systems. One-stop shops and on-line services for imports, exports, and business registration would be supported, as they directly benefit SMEs. Given that according to Doing Business 2010, the time needed to enforce a contract is 1,459 days, the project will support alternative dispute mechanisms. This is a transversal issue affecting value chains since collaborative work often fails because of a breakdown in trust. Also, to complement the risk management work in component one, this component will finance a national risk mapping effort. Lastly, a statistical information gap on SMEs makes SME-oriented policy decisions difficult and will hurt monitoring efforts for the project. The component will finance surveys necessary to obtain adequate information and install a system within MINECO for periodic monitoring.

- **Component 3 - Project Implementation Unit**

This component will strengthen the existing Project Implementation Unit (PIU) used to implement the IDB International Trade project, by adding a project coordinator, an administrative assistant, and a monitoring and evaluation coordinator who report to the steering committee. The PIU will be responsible for financial management, procurement, safeguards, and a monitoring and evaluation (M&E) system. The M&E system will include safeguard checks and
measures. The PIU will be guided by MARN and potentially a contracted social expert in terms of meeting national and Bank safeguards requirements in all activities financed by the project. If deemed necessary during preparation, a social expert, with relevant experience, and will be hired to work for the Project Implementation Unit of the Ministry of Economy to ensure proper execution of the Project’s social safeguards frameworks, namely the IPPF and RPF. This specialist would be charged with the evaluation of potential resettlement impacts and/or affects (both adverse and positive) on indigenous peoples of activities financed under the Action Plans in addition to ensuring proper monitoring and evaluation of Safeguards Plans. In addition, they would be charged with ensuring ongoing consultation with indigenous groups and the promotion of social inclusion within the value chains.

Short term consultants and technical experts from MINECO will be assigned to Component 1 or Component 2, as necessary.

4. Safeguard Policies

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<th>Safeguard Policies Triggered by the Project</th>
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<tr>
<td>Environmental Assessment (OP/BP 4.01)</td>
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<td>Projects on International Waterways (OP/BP 7.50)</td>
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<td>Projects in Disputed Areas (OP/BP 7.60)</td>
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<td>Piloting the Use of Borrower Systems to Address Environmental and Social Safeguard Issues in Bank-Supported Projects (OP/BP 4.00)</td>
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5. Tentative financing

Source: \( ($m.) \)

Borrower  6.0
International Bank for Reconstruction and Development  32.0
Total  38.0

6. Contact point

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