PUBLIC

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

# GUATEMALA

# FISCAL CONSOLIDATION PROGRAM FOR GUATEMALA
# (GU-L1064)

**LOAN PROPOSAL**

This document was prepared by the project team consisting of José I. Larios, Project TeamLeader (FMM/CGU); Alberto Barreix (IFD/FMM), Project Team Co-Leader; Carlos Pineda, Jaime Bonet, Fernando Velayos, and Juan Carlos Benítez (IFD/FMM); Ramiro López Ghio (FMM/CBO); Juan Carlos Perez-Segnini (LEG/SGO); Edna Armendariz (CID/CID); Cecilia del Puerto (PDP/CGU); José Villatoro (PDP/CGU); Yasmin Portillo (FMM/CGU); and Susana Román-Sánchez (IFD/FMM).).

CONTENTS

| Annexes | |
|---|---|
| Annex I | Summary Development Effectiveness Matrix (DEM) |
| Annex II | Policy matrix |

## Electronic Links

**Required**

1. Development Effectiveness Matrix (DEM questionnaire)
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36985640
2. Policy letter
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37020806
3. Means of verification matrix
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36937566
4. Results matrix
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36930164
5. Independent macroeconomic assessment
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36940328

**Optional**

1. Impact evaluation and monitoring plan
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36933760
2. Program economic evaluation
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36933696
3. Safeguard filters
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36980215

## ABBREVIATIONS

| | |
|---|---|
| BANGUAT | Bank of Guatemala |
| DAAFIM | Dirección de Asistencia a la Administración Financiera Municipal [Municipal Financial Administration Assistance Division] |
| ECLAC | Economic Commission for Latin America and the Caribbean |
| FFF | Flexible Financing Facility |
| FSO | Fund for Special Operations |
| GCS | Mancomunicad de la Gran Ciudad del Sur |
| INFOM | Instituto de Fomento Municipal [Municipal Development Institute] |
| LIBOR | London Interbank Offered Rate |
| MINFIN | Ministry of Public Finance |
| OC | Ordinary Capital |
| OECD | Organization for Economic Co-operation and Development |
| PBL | Policy-based loan |
| PEFA | Public Expenditure and Financial Accountability |
| RTCO | Reimbursable technical-cooperation operation |
| SAT | Superintendencia de Administración Tributaria [Tax Administration Superintendency] |
| SCF | Single Currency Facility |
| SEGEPLAN | Secretaria de Planificación y Programación de la Presidencia [General Planning and Programming Department] |
| SIAF-MUNI | Sistema Integrado de Administración Financiera Municipal [Integrated Municipal Financial Administration System] |
| VAT | Value added tax |

## PROJECT SUMMARY

## GUATEMALA

## FISCAL CONSOLIDATION PROGRAM FOR GUATEMALA
## (GU-L1064)

**Financial terms and conditions**

**Borrower**: Republic of Guatemala

**Executing agency**: Ministry of Public Finance (MINFIN)

| Source | Amount** (US$ million) |
|---|---|
| **Policy-based loan (PBL) and reimbursable technical-cooperation operation hybrid** | |
| **Policy-based loan (PBL)** | |
| **IDB**: Ordinary Capital (OC) - FFF | **72.0** |
| OC/SCF blended | **129.6** |
| Fund for Special Operations (FSO) blended | **32.4** |
| **Reimbursable technical-cooperation operation** | |
| **IDB:** OC/SCF blended | **2.56** |
| FSO blended | **0.64** |
| **Total** | **237.2** |

**Flexible Financing Facility (FFF)***

| | Blended (PBL and technical-cooperation operation) | | PBL |
|---|---|---|---|
| | **OC/SCF** | **FSO** | **OC/FFF** |
| **Original average weighted life (years):** | | | 12.75 |
| **Interest rate:** | LIBOR | 0.25% | LIBOR |
| **Grace period (years):** | 5.5 | 40 | 5.5 |
| **Inspection and supervision fee:** | * | - | * |
| **Amortization period:** | 30 | 40 | 20 |
| **Disbursement period:** | 3 years | 3 years | 3 years |
| **Credit fee:** | * | - | * |
| **Approval currency:** | United States dollars (US$) | | |

**Program at a glance**

**Program objective and structure**. The objective of this program is to strengthen Guatemala's fiscal sustainability through increased fiscal revenues, stronger tax administration and mechanisms for controlling national and municipal borrowing, and improved quality of spending in a medium-term fiscal framework. The program is structured into two components: a multitranche policy-based loan (PBL) and a reimbursable technical-cooperation operation (RTCO). The PBL is a two-tranche operation for US$234 million, and the RTCO is for US$3.2 million. Each tranche of the PBL will be for 50% of the total PBL amount.

**Special contractual conditions.** Disbursement of resources from the PBL component will be contingent on the borrower's fulfillment of the conditions set forth in Annex II, the Policy Matrix, to this document (see also the Results Matrix). The Bank will make the first disbursement for the RTCO component once the following special conditions have been met: (i) appointment of the executing unit for the institutional strengthening component, within MINFIN; (ii) presentation of the annual work plan and the procurement plan for the first year of execution; (iii) opening of a special account in U.S. dollars for execution of this component; (iv) signature by MINFIN, as the executing agency, of two interagency agreements—one with Instituto de Fomento Municipal [Municipal Development Institute] (INFOM), and the other with the association of municipios known as Mancomunidad de la Gran Ciudad del Sur, as recipients of the technical assistance (see paragraph 1.39).

**Exceptions to Bank policies:** None.

**Project consistent with country strategy:** Yes [ X ] No [ ]

**Project qualifies as**: SEQ [ ] PTI [ ] Sector [ ] Geographic [ ] Headcount [ ]

**(*)** The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

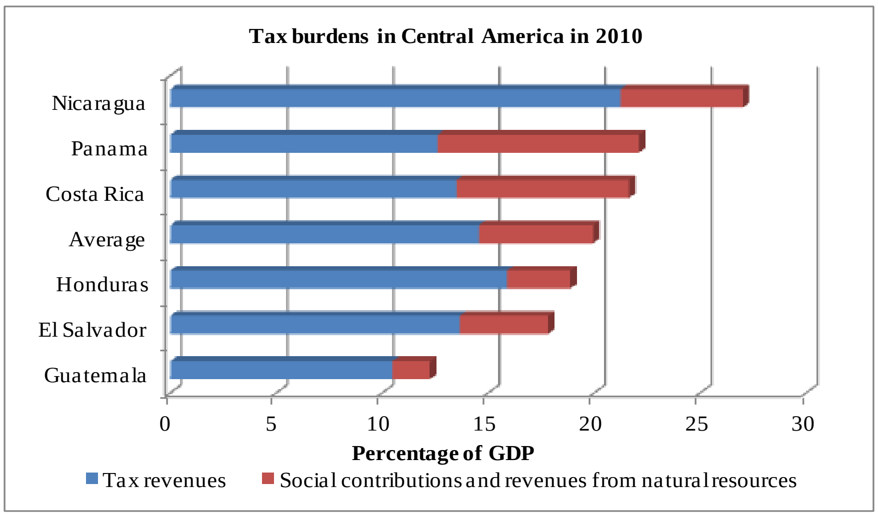
(**) The amount of this operation will be a maximum of US$237.2 million, and will be determined exactly before the operation is submitted to the Board of Executive Directors for consideration.

# I. DESCRIPTION

## A. Background

### 1. Introduction

1.1 Guatemala is a unitary State with a national tax burden at more than 10% of GDP since 1996, and low levels of municipal own revenues (approximately 1% of GDP). From a technical standpoint, this is partly due to a number of equity- and efficiency-related structural failures in the direct taxation system. The causes of this are high rates of avoidance, evasion, and smuggling resulting from a relative lag in tax legislation.[1]




1.2 As a result of the global financial crisis, Guatemala's tax burden, which in recent years had ranged from 11% to 12% of GDP, fell to 10.2% of GDP in December 2009. Because municipios rely on fiscal transfers, the decline in the tax effort caused liquidity problems in municipal finances. To alleviate the adverse effects of the international financial crisis in 2009, the government implemented a countercyclical fiscal policy,[2] which caused the fiscal deficit to increase from 1.6% of GDP in 2008 to 3.1% in 2009.

1.3 The fiscal recovery was further complicated in 2010 by natural disasters that struck the country, such as the eruption of Pacaya Volcano and the arrival of Tropical Storm Agatha. The impact of these disasters was felt in public infrastructure (transportation and education), damaged housing, and agricultural losses (Economic Commission for

---

[1] "La política fiscal de Centroamérica en tiempos de crisis" [Fiscal Policy in Central America in Times of Crisis], Central American Institute for Fiscal Studies, March 2012, and "La tributación directa y los desafíos a la imposición sobre la renta," [Direct taxation and the challenges of taxing income], Cetrángolo and Gómez Sabaini for the Economic Commission for Latin America and the Caribbean, 2007.

[2] The National Economic Emergency and Recovery Program was established and implemented.

Latin America and the Caribbean, 2011). As a result, the fiscal deficit rose slightly to 3.3% of GDP in 2010.

1.4 Lastly, public debt rose by four percentage points of GDP between 2008 and 2010 (from 20% to 24.1%). In 2011, the economy grew by 3.7% of GDP, and the fiscal deficit ended the year at 2.4% of GDP. In that year, invigorated domestic economic activity and international trade, combined with the efforts of the Tax Administration Superintendency (SAT), helped bring about a rise in tax revenues from 10.5% of GDP in 2010 to 11% in 2011. In 2011 public debt remained at the same level as in 2010, and rose to 24.7% in 2012. The recently approved tax reform package and efforts to make public spending more efficient will aid in the fiscal consolidation process. Implementation of the tax reform package is expected to increase tax collections by an estimated 1% to 1.5% of GDP starting in 2013.

### 2. Macroeconomic situation

1.5 Prices have remained stable in Guatemala, but potential external shocks—especially an increase in worldwide food and oil prices—could generate inflationary pressures. By late 2011, the inflation rate was at 6.2%, slightly above the high end of the target range (5% +/– 1 percentage point). Guatemala's central bank, BANGUAT, projects inflation to be about 5.3% by late 2012, which is within the target range (4.5% +/– 1%).

1.6 The current account deficit has stayed within manageable ranges and has been financed by relatively stable currency flows, with foreign direct investment financing half of this deficit. The current account deficit was 3.6% of GDP in 2011, which was up from 2010 (1.5% of GDP). For 2012, BANGUAT projects a current account deficit similar to that of the previous year (3.7% of GDP). Also, Guatemala's international liquidity indicators are sufficient to meet any financial needs that may suddenly arise. The ratio of international reserves to short-term external debt was 115% in 2011.

1.7 GDP grew at an average of 2.6% per year from 2008 to 2011. Economic growth picked up in 2011 (3.8%), mainly due to greater external demand and a recovery in private-sector consumption. For 2012, BANGUAT projects GDP to grow between 2.9% and 3.3%. According to the FocusEconomics Consensus Forecast, GDP should grow at a rate of about 3% over the coming years, which is less than its potential. Although the economic confidence index is at its highest point in the last five years, global risks remain high, and therefore the economic growth outlook in Guatemala is moderate. There is little leeway for the adoption of countercyclical policies.

### 3. Diagnostic assessment of the problem

1.8 Public finances in Guatemala have four fundamental problems: (i) low levels of tax revenues, which are vulnerable to international shocks since they are based on indirect taxes, and since the country's income tax system[3] allows for tax avoidance

---

[3] In the past five years, personal income tax collections have averaged 0.3% of GDP, less than one fourth of the Latin American average of 1.3% of GDP.

and therefore has limited collection capacity; (ii) limited institutional and coordination capacity between the Ministry of Public Finance (MINFIN) and the SAT, which makes it difficult to face the challenges related to transparency and international taxation; (iii) rigid budgetary laws and regulations that have hindered the efficient use and targeting of expenditures to attain measurable results; (iv) an institutionally weak fiscal decentralization process, due to a lack of coordination between entities of the central government and municipalities, which hinders effective recordkeeping and monitoring of municipal debt; and (v) limited financial and institutional capacity at the municipal level in the provision of public services.

1.9 Guatemala's tax structure is highly dependent on indirect taxes, and particularly the value added tax (VAT), which in the last 20 years has played an ever larger role. In the 2009 global crisis, dependence on the VAT exposed the tax system's high vulnerability to external influences, as receipts fell 4.6% from 2008 to 2009 as a result of a 74% drop in the VAT, especially in the VAT from imports, a category highly dependent on oil and oil derivatives. To strengthen and complement tax policy, loopholes for avoiding and evading taxes must be closed through administrative measures. This requires a series of legal measures including provisions in the Tax Code to regulate the relationship between taxpayers and the taxing authorities, as well as specific definitions of the main taxes regarding their respective tax base.[4] This requires strengthening direct taxation and diversifying the tax base.

1.10 Guatemala's income tax system is very complex, and income tax collections are paltry. The system has various interrelated parts: (i) a general 5% tax on gross income; (ii) an alternative 31% tax on net income; (iii) a 1% tax on net assets or gross income, as the case may be, which is deductible from the income tax (currently termed Solidarity Tax); and (iv) a progressive income tax on work performed as an employee, as well as other taxes. As it is possible to change from one tax type to another with near-total ease in any fiscal year (from the general tax to the alternative tax or vice versa), and taxpayers need only notify the SAT of their decision before each calendar year, the system offers taxpayers ongoing opportunities to avoid paying taxes. The income tax also has very serious problems, such as the VAT credit for taxpayers' purchases, the inclusion of various forms of capital income to the exclusion of others, such as dividends, and a lack of international tax provisions.

1.11 As a result of the 2008 financial crisis, an international movement emerged in favor of fiscal transparency and international cooperation against tax fraud. This is reflected in the tax transparency standards established by the Organization for Economic Co-operation and Development (OECD). The legal implementation and administration of these standards is being evaluated by the Global Forum, which consists of more than 100 countries, with the aim of encompassing all jurisdictions within five years. In the Global Forum's first review phase, Guatemala did not meet

---

[4] The income tax evasion rate is 70% of potential receipts from individuals and 51% from businesses. Source: Jiménez, Gómez Sabían, and Podesta (2008), ECLAC; and Pecho, Peláez, and Sánchez (2012 copy), Inter-American Center of Tax Administrations.

the international standards for transparency and exchange of tax information. Guatemala is one of the few Latin American countries on the OECD's gray list of tax havens that do not share information for taxation purposes.

1.12 Fiscal decentralization in Guatemala has a weak institutional framework and municipal debt framework due to a lack of effective fiscal regulations, because MINFIN lacks a specialized unit for this purpose. Also, the Instituto de Fomento Municipal [Municipal Development Institute] (INFOM) needs to be strengthened in its role as an intermediary and financing entity for municipal investment if it is to perform its duties as an ex ante evaluator of municipal borrowing capacity and to control and monitor borrowing.[5]

1.13 According to 2010 data, municipal own revenues are very low, at 1% of GDP, and the self-sustainability indicator (operating expenses over own revenues) for the aggregate of all 334 municipios is 108%. In all, 74% of all municipal revenues come from the central government, with the remaining 26% coming from the property tax and municipal charges and fees. As a result of low collection levels, municipalities finance themselves by going into debt. One example is financing for short-term cash flow to pay municipal employees,[6] which becomes a short-term debt under onerous conditions for municipal finances (see the electronic link "Municipal Debt and Fiscal Coresponsibility").

1.14 According to the Integrated Municipal Financial Administration System (SIAF-MUNI) and INFOM, municipal public debt remained below 1% of GDP between 2007 and 2010, peaking in 2009—at 0.7%—and dropping to 0.4% of GDP during local governments' next-to-last fiscal year. No validated official data exist on the balance of municipal debt. According to INFOM, for example in 2010 municipalities were indebted to INFOM and the commercial banking system in an amount equivalent to about 0.53% of GDP. Meanwhile, according to the Integrated Municipal Financial Administration System, total debt is approximately 0.43% of GDP. The lack of reliable records covering all liabilities of the municipalities, combined with a lack of financial monitoring of municipal borrowing, led the Guatemalan Congress to pass an amendment to Article 110 of the Municipal Code,

---

5 Huerta Goldman, Antonio. "Consultoría para la definición de una estrategia de Seguimiento y Evaluación del Endeudamiento Municipal en Guatemala" [Consulting Services to Develop a Strategy to Monitor and Evaluate Municipal Borrowing in Guatemala]. MINFIN copy. 2007 (see electronic link).

6 See "Análisis de los Principales Procesos Presupuestarios y de Ejecución del Gasto en la Municipalidad de Guatemala" [Analysis of Main Processes for Budgeting and Executing Spending in the Municipality of Guatemala City]. Inter-American Development Bank. December 2009. See also "Diagnóstico de la Situación Fiscal – Financiera de la Municipalidad de Panajachel, Sololá" [Diagnostic Assessment of the Fiscal and Financial Situation in the Municipality of Panajachel, Sololá]. November 2009.

restricting municipalities from taking on loans that entail repayment obligations beyond the term of municipal government.[7]

1.15 The lack of control over municipal debt and the low level of municipal investment (0.4% of GDP) are the result of a fiscal decentralization process not regulated by MINFIN, with INFOM designated as the lending intermediary. The only requirement is that a municipality be confirmed to have room to service debt on the total of the constitutional contribution and the value added tax, known as VAT-Peace, transferred to it by the central government.

1.16 In 2010, the Public Expenditure and Financial Accountability (PEFA) report was prepared at the initiative of the Government of Guatemala and with the support of the IDB, the World Bank, and the European Union. It found that the process developed by Guatemala over the past 15 years for reforming public financial administration has achieved very significant progress. The PEFA report states that there are several aspects of the financial administration system that detract from its virtues, such as: (i) a lack of coordination between the budget and sector needs, because even though the annual cap set by Congress for the budget is observed, interagency reallocations are significant and distort sector targets; and (ii) the ongoing use of parallel practices in budget execution, which limits the credibility of public financial information and highlights the perceived lack of transparency due to noncompliance with current procurement regulations.

**Table 1.1**
**Breakdown of public spending (% of GDP)**

| Period | Current spending | Capital spending | | |
|---|---|---|---|---|
| | | Total | Direct investment | Financial investment and transfers |
| 1995-1999 | 8.1 | 4.3 | 1.7 | 1.8 |
| 2000-2008 | 9.6 | 4.6 | 1.5 | 3.0 |
| 2009-2011 | 10.4 | 4.1 | 1.8 | 2.3 |

Source: Ministry of Public Finance.

1.17 The foregoing falls within the constitutional and public-policy parameters set forth in the budget laws passed by Congress. This means that budgeting is highly rigid, since 89% of resources are committed to: specific sectors (38.6%), wages (21.3%), service on public debt (14%), contributions to public-sector entities (8.5%) and pensions (6.6%), with only 11.1% of the budget freely available for fiscal and social policy

[7] The Constitutional Court's ruling of 7 June 2012 allows for loan obligations to be taken on with a repayment period that extends beyond the term of the Municipal Council that contracts such obligations, provided the long-term borrowing is supported by the conclusions and recommendations of technical feasibility studies completed for this purpose.

decisions. As a result, most resources are used for current spending, to the detriment of public investment and results-based management.

1.18 Guatemala needs to make progress in its culture for planning and projecting public accounts, as well as in monitoring and evaluating public spending. In view of the new administration's commitments, such as the Zero Hunger Plan, strengthening of public security, and the need to modernize productive infrastructure, the country needs to make government finances more predictable by using multiyear budgeting. Multiyear budgeting must be made part of the institutional landscape and accompanied by estimations of the medium-term fiscal framework and a policy on national and local public borrowing. With fiscal revenues scarce, it is imperative to maintain an updated evaluation of public spending, to begin using results-based budgeting, and to strengthen municipal finances to increase the quantity and enhance the quality of municipal investment.

1.19 The financial weaknesses of urban municipalities exert pressure on the central government to take on municipal public investments. Meanwhile, municipios are forming associations[8] to combine their financial and institutional forces in order to produce municipal public goods and provide municipal services. The interrelationship of these developments has led MINFIN to promote the institutional strengthening of associations of municipios. To experiment with this new type of municipal organization, the Government of Guatemala decided to strengthen the newly formed Mancomunicad de la Gran Ciudad del Sur (GCS), consisting of the municipalities of Mixco, Villa Nueva, San Miguel Petapa, Amatitlán, Villa Canales, and Santa Catarina Pinula. The GCS is an urban microregion in the Guatemala City metropolitan area; the National Statistics Institute projects that 50% of the urban population of the Department of Guatemala will reside in the GCS by 2020. These six municipalities exhibit varying degrees of financial solvency and coverage of public services such as water, sanitation, and solid waste.[9] In short, low levels of tax collection and budgetary rigidity prevent the government from directing and targeting its spending and investment based on the priority areas for local economic and social development in the country.

1.20 The Bank has been promoting such reforms in the region (dual and semidual income tax systems). Examples include the reforms in Uruguay (2007), Nicaragua (2009), Honduras (2010) and, most recently, El Salvador (2011). Similar progress has been made in Peru (2008) and Panama (2010) with the Bank playing a less direct role. Though it is too early to draw conclusions on the dual and semidual tax systems, the longest-running reform process (Uruguay's) is clearly yielding positive results, with

---

[8] An association of municipios (termed *mancomunidad*) has legal status and is formed through agreements signed by the councils of two or more municipios for joint development of municipal public policies, plans, programs, and projects, execution of works, and efficient provision of services in their jurisdiction (providing water services, drainage and sewerage service, solid waste service, electrical lighting, streets, and markets).

[9] La Gran Ciudad del Sur – Visión 2012.

an increase from 0.9% of GDP in 2006 to 2.4% in 2008. Also, the poorer half of Uruguay's population went from providing 12.2% of tax receipts to only 3.5%, while the share paid by the highest income quintile rose from 60.4% to 80.5%.[10]

1.21 As for the fiscal and municipal institutional framework, empirical evidence in Colombia and Brazil[11] suggests that: (i) a lack of clear rules on municipal borrowing and high levels of municipal autonomy lead to overindebtedness and excessive public spending, which eventually generates pressure on the central government to assume subnational debt and compromises macroeconomic stability. Meanwhile, academic studies[12] suggest that to reverse the trend toward excessive borrowing and steer municipalities toward providing public services, fiscal entities and regulations need to be built to promote increased collections of own revenues, as a way of establishing a local link between the cost of providing these services and the benefits of basic services.

1.22 **Rationale.** The Government of Guatemala requested the Bank's support in strengthening its fiscal policy and building a new institutional framework to help support the country's fiscal consolidation. This effort is part of current government policy, which is built on the Fiscal and Competitiveness Pact, the Zero Hunger Pact, and the Peace, Security, and Justice Pact. The operation is aligned with the Bank's current (2008-2011) Country Strategy with Guatemala, specifically the fourth objective on fulfillment of the collection targets set forth in the peace accords, by increasing the overall tax burden to 13.5% of GDP. Laws to update the tax system and combat smuggling and tax evasion entail a 1% increase in tax collection as a percentage of GDP, which is significant for Guatemala. This operation supports the effort to fulfill two of the targets set forth in the Ninth General Capital Increase (GCI-9): (i) financing for small and vulnerable countries; and (ii) financing for poverty reduction and equity enhancement. The program is also consistent with the 2012-2016 country strategy, currently under preparation, which makes fiscal consolidation a priority area for the Bank's intervention.

1.23 The Bank has been playing a leading role in providing technical assistance to the country both in tax policy and tax administration since the restoration of the Fiscal Pact in 2008, and in coordination with the International Monetary Fund and bilateral donors. This had led to significant progress that still needs to be consolidated. The operations related to this program are a technical-cooperation operation, currently

---

[10] For more details, see Barreix and Roca (2007). "Reforzando un pilar fiscal: el impuesto a la renta dual a la uruguaya" [Strengthening a Fiscal Pillar: Dual Income Tax, Uruguayan-style]. ECLAC Journal 92 August: 123–42.

[11] "10 Años de Transformación Fiscal Territorial en Colombia 1998–2008" [10 Years of Subnational Fiscal Transformation in Colombia 1998–2008]. Ministry of Finance and Public Credit of the Republic of Colombia, 2009; and "El BID y el Ajuste Fiscal y Modernización de los Estados Brasileños" [The IDB and the Fiscal Adjustment and Modernization of Brazilian States], ECLAC 2009.

[12] Stein, Ernesto. *Fiscal Decentralization and Government Size in Latin America*. *Journal of Applied Economics*, Vol. II, No. 2 (Nov. 1999), 357-391; and Weingast, Barry R. "*Second Generation Fiscal Federalism: the Implications of Fiscal Incentives,*" *Journal of Urban Economics* 65 (1009) 279-293.

under execution, to support specific activities related to municipalities (Fiscal Decentralization in Guatemala, operation ATN/FG-12528-GU); in addition, a technical-cooperation operation will be prepared to support this program and to support MINFIN in strengthening four main areas of fiscal policy: (i) development of macroeconomic instruments to support fiscal policy design; (ii) strengthening of analytic capacity and development of instruments to plan, execute, and monitor the State's revenue policy; (iii) development of analytic and public policy-making capacity in the planning, execution, and results-based monitoring of public spending; and (iv) development of analytic capacity and instruments to generate public borrowing guidelines.

## B. Program objectives and components

1.24 The objective of this program is to strengthen Guatemala's fiscal sustainability through increased fiscal revenues, stronger tax administration and mechanisms for controlling national and municipal borrowing, and improved quality of spending in a medium-term fiscal framework. The program is structured as a multitranche policy-based loan (PBL) and a reimbursable technical-cooperation operation (RTCO). The PBL is a US$234 million operation consisting of two equal tranches, and the RTCO is for US$3.2 million. The RTCO component will focus on the institutional strengthening of public-sector actors that will participate in the fiscal and financial aspects of the decentralization process: MINFIN, INFOM, and the association of municipios known as Mancomunidad de la Gran Ciudad del Sur. The components of the PBL are outlined below:

1.25 **Component I. Macroeconomic stability.** To support prudent macroeconomic management of the Guatemalan economy, this program requires as a general condition for the disbursement of both tranches that a stable macroeconomic policy be maintained, in accordance with the program's objectives and the guidelines set forth in Guatemala's sector policy letter (see electronic link).

1.26 **Component II. Tax reform.** To strengthen the taxation component of fiscal sustainability, the Tax Modernization Act (Decree 10-2012) was passed in February 2012. This legislation includes a new income tax law, a law taxing the initial registration of land-based motor vehicles, the National Customs Act, and reforms to the Law on Taxation on Circulation of Land, Sea, and Air Vehicles. These laws will go into effect in 2012, with the exception of the income tax law, which will take effect in 2013.

1.27 Regarding the income tax: (i) international fiscal standards are being introduced by adopting international best practices, e.g., transfer prices, undercapitalization rules, and definition of permanent establishment and residence; (ii) the tax base is being expanded by including all capital revenues and capital gains for both individuals and companies (dual system); (iii) deductions are specified and updated, and specifically the credit for VAT purchases is eliminated and turned into a simple deduction capped at 12,000 quetzales; and (iv) the simplified tax on gross income is increased by 40% (new rate of 7%). The new tax on the initial registration of motor vehicles is assessed

at rates ranging from 5% to 20%, depending on vehicle type, and the tax rates on land-based vehicles were nearly doubled. Lastly, the National Customs Act was updated; this law establishes procedures and provisions supplementing regional customs laws, describes administrative infractions, and outlines the corresponding sanctions.

1.28 The Law on Provisions for the System to Strengthen the Tax System and to Combat Fraud and Smuggling (known as Anti-evasion Act II), Decree 4-2012, which was passed by Congress in late January 2012, contains provisions to close tax loopholes: (i) in income tax, by reducing and more specifically defining deductions and expanding the tax base through special invoicing and withholding for small-scale exporters of agricultural, handcrafted, and recycled products; and (ii) in the VAT, by eliminating the fiscal credit on invoices issued by small-scale taxpayers, the use of special invoicing, and new requirements for withholding and for providing the tax administration with detailed information on goods and services purchased and sold. The taxable base for the tax on tobacco products was restored, and the tax rates for tax stamps and special letterhead for official instruments, *inter alia*, were updated.

1.29 The second tranche will strengthen tax administration by: (i) creating the International Taxation Department under MINFIN's Vice Ministry for Revenues and Tax Assessment, which is tasked, *inter alia*, with negotiating taxation agreements and tax information exchange treaties; and (ii) issuing regulations for the Tax Modernization Act and the Anti-Evasion Act II for the sake of effective implementation. It also calls for signing at least 12 tax information exchange agreements with other countries. This will allow Guatemala to negotiate its way off the OECD's list of tax havens and to avoid tax-related discrimination by other jurisdictions.

1.30 **Component III. Regulation of municipal finances.** To strengthen the fiscal institutional framework, particularly MINFIN's capacity as the entity responsible for regulating and monitoring municipal public finances,[13] the Municipal Financial Administration Assistance Division (DAAFIM) will be formed as part of MINFIN. DAAFIM's main duties will be to: (i) coordinate the completion of studies of municipal finances (revenues, outlays, and transfers); (ii) develop financial and fiscal sustainability indicators for municipios; (iii) design and implement guidelines to guide municipios' work to develop municipal finances; and (iv) provide technical assistance to municipalities on financial administration and municipal debt.

1.31 The second tranche prioritizes the management and control of municipal borrowing through fulfillment by MINFIN of the following tasks: (i) development and implementation of guidelines on DAAFIM's organization, duties, rules, and procedures; (ii) design and implementation of a mechanism for monitoring municipal finances to enable DAAFIM to monitor these finances on an ongoing basis; the mechanism will serve as input for the Public Credit Office and INFOM; and (iii) consolidation of a methodology for quantifying the debt held by each municipio.

[13] Based on Article 134(A) of the Guatemalan Constitution and the Executive Branch Act, Decree 114-97.

INFOM, in turn, will prepare the guidelines on the organization, duties, rules, and procedures of DAAFIM's credit and portfolio areas that are consistent with its Administrative and Financial Reorganization Plan

1.32 **Component IV. Medium-term fiscal programming and results-based management.** In view of the conclusions of the PEFA assessment, and acting through the Project to Support Budget Management financed by the European Union for the Government of Guatemala, in 2010 MINFIN prepared an action plan to correct or address the limitations that had been noted. An update to the PEFA report should be prepared in 2012 to check the progress made in the action plan; in coordination with MINFIN, the European Union, the IDB, and the World Bank will update the PEFA report.

1.33 For the second disbursement, based on the recommendations in the PEFA report, a pilot plan for results-based management will be carried out in the Ministry of Health's Program to Promote Preventive Health Care and Medicine, which is at the heart of the focus on social inclusion in the 2012-2016 government program. Also, to begin the multiyear budgeting process, the medium-term fiscal programming framework will be implemented, including an analysis and guidelines on national and municipal debt. This will include estimates of the leading medium-term fiscal aggregates, to be posted on the MINFIN website, as part of preparation of the 2014 draft budget.

1.34 **Reimbursable technical-cooperation operation (RTCO) to be executed by MINFIN,** through the Vice Ministry for Financial Administration, to support institutional strengthening of public-sector actors that will participate in the fiscal and financial aspects of the decentralization process in Guatemala, specifically MINFIN, INFOM, and the Mancomunidad de la Gran Ciudad del Sur, by providing technical assistance to consolidate this new virtuous cycle. The project will feature the following components:

1.35 **Component I. Strengthening of regulation, coordination, and planning activities (US$1 million)**. This component is aimed at increasing the coordination and institutional capacity of entities responsible for municipal governments' finances and borrowing (see electronic link) by: (i) strengthening the analytic capacity of DAAFIM and the Public Credit Division; (ii) designing and implementing municipal financial and fiscal solvency indicators at the national and municipal levels; and (iii) training personnel from DAAFIM, the Public Credit Division, and INFOM in analyzing, controlling, and advising on municipal finances. This component will also finance the installation and operation of the executing unit that will implement this component, pursuant to Clause 5.02(b)(i) of the Special Conditions, together with the external audit for this component.

1.36 **Component II (US$1 million). Strengthening of INFOM's technical capacity.** This component will support INFOM's organizational reform and institutional strengthening process, in its role as financial agent and intermediary for municipal lending and in its provision of technical assistance to municipalities based on its

Modernization Plan (which in turn is a condition precedent to disbursement of the second tranche of the PBL's municipal component). This component will implement a new organizational model for the institution, strengthen INFOM's role as an intermediary for municipal debt, and implement a new model to execute municipal public investments.

1.37 **Component III (US$1.2 million). Strengthening of the Mancomunidad de la Gran Ciudad del Sur and its member municipalities (pilot plan).** At MINFIN's request, a pilot plan will be developed for the institutional strengthening of the association of municipios known as Mancomunidad de la Gran Ciudad del Sur. This component will include the following activities: (i) design, implementation, and monitoring of the association's institutional strengthening plans; (ii) design and implementation of rates and regulation of charges for association services; (iii) workshop to disseminate and raise awareness of joint investment projects in the various sectors of the association; and (iv) completion of feasibility and preinvestment studies for joint works.

1.38 The RTCO will be executed by MINFIN, acting through DAAFIM. MINFIN is the lead agency for public finances in Guatemala and, as such, possesses a high degree of institutional capacity for the financial management of projects. Project procurement activities will be conducted in accordance with the policies set forth in documents GN-2349-9 and GN-2350-9 of April 2011, under the responsibility of MINFIN.

1.39 The Bank will make the disbursement for this component once the following special conditions have been met: (i) appointment of the executing unit for the institutional strengthening component, under MINFIN; (ii) presentation of the annual work plan and the procurement plan for the first year of execution; (iii) opening of the special account in U.S. dollars for execution of this component; (iv) signature by MINFIN, as the executing agency, of two interagency agreements—one with INFOM and the other with Mancomunidad de la Gran Ciudad del Sur, as recipients of the technical assistance.

## C. Primary outcomes and indicators

1.40 The disbursement of resources from the financing for each tranche of the program will be contingent on the fulfillment of conditions set forth in Annex II to this document. Complementing this are the expected program outcomes summarized in the Results Matrix (see electronic link). The program's main expected outcomes are: (i) to contribute to stable, sustained growth in a balanced macroeconomic framework; (ii) to collect at least an additional 1% of GDP; (iii) to strengthen MINFIN's capacity to regulate and guide municipal finances; and (iv) to improve budget policy and spending management within a medium-term fiscal framework as a policy tool, and provide greater public access to information on public management.

1.41 The main indicators listed by component in the Policy Matrix (Annex II) are: (i) an increase in collections of at least 1% of GDP as a result of the tax reform and the Anti-evasion Act II; (ii) total municipal debt as a percentage of own revenues

decreased from 94% in 2009 to 85% in 2013; and (iii) increases in current spending are controlled from a baseline of 10.4% of GDP in 2011 to 10.5% in 2013.

## II. Financial Structure and Primary Risks

### A. Financial instrument

2.1 The program consists of a hybrid loan for US$237.2 million, which includes a multitranche policy-based loan (PBL) and a reimbursable technical-cooperation operation (RTCO). PBL proceeds will be disbursed in two tranches of US$117 million each after the general and special policy conditions in the attached Annex II (Policy Matrix) are found to have been fulfilled. The RTCO will strengthen the information systems keeping records on municipal financial operations, and will support the strengthening and modernization of INFOM; and the institutional and financial strengthening of the Mancomunidad de la Gran Ciudad del Sur. The loan amount was determined by MINFIN on the basis of technical projections of revenues, expenditures, investment targets, and borrowing targets for the 2012-2016 term. This borrowing represents 0.5% of GDP.

2.2 Program financing, for a total of US$237.2 million, is structured to come from two sources: (i) US$132.2 million from the Single Currency Facility of the Bank's Ordinary Capital and US$33 million from the Fund for Special Operations (FSO), based on the blend of resources in the Bank's new concessional financing framework; and (ii) US$72 million from the new Flexible Financing Facility of the Bank's Ordinary Capital (document FN-665-1).

2.3 Support will also be provided to implement policy agreements through the institutional strengthening of MINFIN with a nonreimbursable technical-cooperation operation to be approved by 30 November 2012 for up to US$800,000. This nonreimbursable technical-cooperation operation will include: (i) strengthening of the analytic and technical capacity to play and regain a leading role in designing and executing fiscal policy; (ii) support for coordination and implementation of tax policy between MINFIN and the SAT; (iii) support for policies to promote greater transparency and quality in spending; and (iv) support for the design and implementation of public credit policies.

### B. Coordination with other financing and cooperation agencies

2.4 The Bank is executing loan 2050/OC-GU (Support for Modernization of MINFIN). This loan will be coordinated with the RTCO through technical support for MINFIN to consolidate the SIAF-MUNI. Meanwhile, the German cooperation agency is working with MINFIN on fiscal policy and is supporting the General Planning and Programming Department (SEGEPLAN) of the Office of the President in designing and implementing municipal governance indicators. Project preparation has been coordinated with the World Bank, which has an operation to provide budgetary support in the fiscal area.

## C. Economic rationale

2.5 This operation supports fiscal consolidation through policy reforms and improved tax administration, along with building MINFIN's capacity to guide and supervise municipal finances and debt. Indeed, the tax reform will generate net fiscal revenues of around 7.5% of GDP at present value over the next 10 years, subtracting the cost of collections and discounting public bonds at the going interest rate (see electronic link).

## D. Environmental risks and other key considerations and risks

2.6 According to Directive B.13 of the Bank's Environment and Safeguards Compliance Policy (document GN-2208-20 and policy OP-703), and since this is a sector policy loan and RTCO, no ex ante classification of environmental impact is required. The environmental risk rating reflects the fact that the RTCO's policy changes and actions will not have a direct or significant impact on the environment or on the country's natural resources.

## E. Other key considerations and risks

2.7 The risks in the operation were analyzed with the participation of government authorities as part of the program analysis mission. The primary risks are that: (i) the Tax Administration Superintendency (SAT), an autonomous government agency, may have technical and political disagreements with MINFIN, leading to a delay in issuing regulations and therefore in implementing tax laws; and (ii) municipalities may refuse to accept the system of fiscal and financial solvency indicators as a condition precedent to the assumption of any new debt, clinging to the longstanding concept of municipal autonomy. Notably, the Tax Modernization Act (Decree 10-2012) and the Law of Provisions to Strengthen the Tax System and Combat Fraud and Smuggling (Anti-evasion Act II, Decree 4-2012) have already been passed by the Guatemalan Congress.

2.8 To mitigate these risks: (i) the Bank is supporting a technical dialogue between MINFIN and the SAT to arrive at technical points of consensus that may not be overruled by the SAT Board of Directors; and (ii) the Bank, through technical-cooperation operation ATN/FG-12528-GU—approved on 2 December 2010—will support the effort to raise awareness on the new municipal-debt rules among the country's 334 municipalities.

# III. Implementation and Management Plan

3.1 **Summary of implementation arrangements**. The borrower will be the Republic of Guatemala. The executing agency will be the Republic of Guatemala, acting through MINFIN. MINFIN will have the following responsibilities for both the PBL and the RTCO: (i) to submit reports and evidence of fulfillment of conditions precedent to the disbursement of resources from the financing for this operation, as well as any other reports required by the Bank; (ii) to promote actions conducive to achieving the policy objectives set forth in the program; and (iii) to gather, store,

and submit to the Bank all information, indicators, and parameters to help Guatemala and the Bank monitor and evaluate program outcomes. For the RTCO, and in addition to the aforementioned responsibilities, MINFIN will act through DAAFIM to: (i) commission independent auditing services; (ii) manage and supervise the program; (iii) monitor progress in the operation; and (iv) monitor and fulfill the program's contractual aspects.

3.2 **Summary of agreements for monitoring outcomes.** The borrower and the Bank have agreed to supervise program execution through monitoring meetings, the dates of which will be decided jointly. Upon completion of each tranche of the operation, the project team will prepare a simplified version of the progress report. The report will include a measurement of program indicators to determine progress in achieving these indicators and carry out the changes needed to meet targets.

3.3 The Bank, in coordination with the borrower, will submit a project completion report for the PBL and the RTCO within six months following fulfillment of the conditions precedent to disbursement of the second tranche. This report will assess the impact achieved and the extent to which the program's expected outcomes were attained. The borrower previously reached an agreement with the Bank on the indicators and baseline for this final evaluation. The executing unit in MINFIN will be responsible for the progress monitoring report.

3.4 The borrower will be responsible for compiling and processing all data needed to monitor and evaluate the operation, including the related financial costs. Consulting services to verify the indicators in the Results Matrix (see electronic link) and the activities in the Policy Matrix (Annex II) will be financed with the Bank's administrative resources.

## IV. POLICY LETTER

4.1 The Bank has reached an agreement with the Republic of Guatemala on the macroeconomic and sector policies included in the Policy Letter sent by the Ministry of Public Finance on 2 July 2012 (see electronic link). The letter outlines the main components of the government's strategy being implemented in the program's action areas described in this document, and reaffirms the government's commitment to implement the reforms and activities agreed upon with the Bank.

| Development Effectiveness Matrix | | | |
|---|---|---|---|
| **Summary** | | | |
| *I. Strategic Alignment* | | | |
| **1. IDB Strategic Development Objectives** | **Aligned** | | |
| | **The project contributes to lending to small and vulnerable countries and lending for poverty reduction and equity enhancement.** | | |
| **Regional Development Goals** | **The project contributes to: (i) Extreme poverty rate, and (ii) Ratio of actual to potencial tax revenue.** | | |
| **Bank Output Contribution (as defined in Results Framework of IDB-9)** | **The project contributes to Banks outputs: (i) Number of households with new or upgraded water supply, (ii) New or upgraded sanitary connections, (iii) Public financial systems implemented or upgraded (budged, treasury, accounting, debt, and revenues), and (iv) Municipal governments supported.** | | |
| **2. Country Strategy Development Objectives** | **Aligned** | | |
| **Country Strategy Results Matrix** | **GN-2501** | **(%) tax revenue intake/GDP inaccordance with Peace Accord targets (adjusted).** | |
| **Country Program Results Matrix** | **GN-2617** | **The project is included in the 2011 Country Program Document.** | |
| **Relevance of this project to country development challenges (If not aligned to country strategy or country program)** | | | |
| *II. Development Outcomes - Evaluability* | Highly Evaluable | Weight | Maximum Score |
| | 8.0 | | 10 |
| **3. Evidence-based Assessment & Solution** | **9.1** | **25%** | **10** |
| **4. Ex ante Economic Analysis** | **8.5** | **25%** | **10** |
| **5. Monitoring and Evaluation** | **6.8** | **25%** | **10** |
| **6. Risks & Mitigation Monitoring Matrix** | **7.5** | **25%** | **10** |
| **Overall risks rate = magnitude of risks*likelihood** | **Medium** | | |
| **Environmental & social risk classification** | **B** | | |
| *III. IDB´s Role - Additionality* | | | |
| **The project relies on the use of country systems (VPC/PDP criteria)** | **Yes** | **The project will use: budget, treasury, accounting and reporting, external control, internal audit and procurement (information systems, shopping method, and contracting individual consultants).** | |
| **The project uses another country system different from the ones above for implementing the program** | | | |
| **The IDB's involvement promotes improvements of the intended beneficiaries and/or public sector entity in the following dimensions:** | | | |
| **Gender Equality** | | | |
| **Labor** | | | |
| **Environment** | | | |
| **Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project** | | | |
| **The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan.** | | | |

The objective of the operation is to contribute to the expansion of municipal services in departments in the north of Guatemala and the border with Mexico, which have lower fiscal indicators, and lower access to public services than the rest of the country. The project contributes to lending to small and vulnerable countries and lending for poverty reduction and equity enhancement. The project contributes to regional development goals of: (i) Extreme poverty rate, and (ii) Ratio of actual to potencial tax revenue. The project also contributes to Banks outputs: (i) Number of households with new or upgraded water supply, (ii) New or upgraded sanitary connections, (iii) Public financial systems implemented or upgraded (budged, treasury, accounting, debt, and revenues), and (iv) Municipal governments supported.

The document presents clearly and quantitatively the project´s logic. This logic suggests that the introduction of indebtedness rules for municipalities will provide incentives for municipalities to generate higher local revenues, improve their financial ratios so local fiscal capacity is strengthened, leading to the provision of sustainable additional local services. The proposal connects expected impacts derived from local investments (service coverage) with local municipal fiscal management (financial sustainability) and these to the specific investments financed by the project.

The proposal includes an ex-ante cost benefit analysis and the evaluation and monitoring plan includes an expost one.

# POLICY MATRIX

| Objectives | Tranche I | Tranche II | Outcomes |
|---|---|---|---|
| **I. General macroeconomic policy framework** | | | |
| To maintain a stable macroeconomic framework for economic growth with equity. | Maintenance of a macroeconomic environment conducive to attaining the program objective, which is to strengthen Guatemala's fiscal sustainability through increased fiscal revenues, strengthened mechanisms for controlling national and municipal borrowing, and improved quality of expenditure in a medium-term fiscal framework.<br>**Means of verification:** Independent macroeconomic assessment | | Fiscal sustainability |
| **II. Tax reforms and measures to prevent tax evasion** | | | |
| To update and strengthen the tax system by implementing reforms aimed at preventing tax avoidance and evasion and improving efficiency in tax collection. | Passage of the Tax Update Act (Decree 10-2012) containing the new Income Tax Act, which includes measures such as: (a) the introduction of international taxation, with standards on transfer pricing and undercapitalization rules; (b) the expansion of the tax base by including all capital revenues and capital gains for both individuals and companies (dual system); (c) the elimination of the credit for VAT purchases by turning it into a simple deduction capped at 12,000 quetzales; (d) increasing the simplified tax on gross sales by 40% (new rate of 7%); (e) the law taxing the initial registration of land-based motor vehicles, the National Customs Act, and reforms to the law taxing the use of land, sea, and air vehicles.<br>**Means of verification**: Publication in the *Diario Oficial – Diario de Centroamérica* and entry into force of the Tax Update Act (Decree 10-2012); and the corresponding executive order. | (i) Regulations for the Tax Update Act enter into effect for effective implementation in Tranche II, which will include measures such as: (a) the introduction of international taxation, with standards on transfer pricing and undercapitalization rules; (b) the expansion of the tax base by including all capital revenues and capital gains for both individuals and companies (dual system); (c) the elimination of the credit for VAT purchases by turning it into a simple deduction capped at 12,000 quetzales; (d) increasing the simplified tax on gross sales by 40% (new rate of 7%); (e) the law taxing the initial registration of land-based motor vehicles, the National Customs Act, and reforms to the law taxing the use of land, sea, and air vehicles.<br>(ii) Creation of the International Taxation Department in MINFIN's Office of the Deputy Minister for Revenues.<br>(iii) Signing of at least 12 tax information exchange agreements or their equivalent, in compliance with the guidelines of the Global Forum.<br>**Means of verification:**<br>(i) Publication in the *Diario Oficial – Diario de Centroamérica* and entry into force of the law's regulations. | Additional tax collection: 1% of GDP |

| Objectives | Tranche I | Tranche II | Outcomes |
|---|---|---|---|
| | | (ii) Publication in the *Diario Oficial – Diario de Centroamérica* of the executive order creating the International Taxation Department.<br>(iii) Copy of at least 12 tax information exchange agreements or their equivalent.<br>(iv) Independent consultant's report. | |
| | Passage of the Law on Provisions for the System to Strengthen the Tax System and to Combat Fraud and Contraband (Anti-evasion Act II, Decree 4-2012)<br>**Means of verification**: Publication in the *Diario Oficial – Diario de Centroamérica* and entry into force of the law. | Regulations for the Law on Provisions for the System to Strengthen the Tax System and to Combat Fraud and Contraband, which will include measures such as: (a) implementation of income tax withholdings; (b) the elimination of the tax credit on invoices issued by small-scale taxpayers; and (c) the restoration of the tax base for the tax on tobacco products.<br>**Means of verification**: Publication in the *Diario Oficial – Diario de Centroamérica* of the regulations for the Law on Provisions for the System to Strengthen the Tax System and to Combat Fraud and Contraband. | |
| **III. Regulation of municipal finances** | | | |
| To strengthen MINFIN's capacity to regulate and guide municipal financial management. | Implementation of the Municipal Financial Administration Assistance Bureau (DAAFIM), created by executive order 394-2008 of 23 December 2008, in the Ministry of Public Finance.<br>**Means of verification**: Hiring of the director and at least one assistant director of DAAFIM in the Ministry of Public Finance. | (i) Preparation and implementation of the guidelines for the organization, functions, rules, and procedures to strengthen the new public policy role of DAAFIM.<br>(ii) Preparation and implementation by INFOM of the guidelines for the organization, functions, rules, and procedures of the Credit and Portfolio areas of INFOM's Administrative and Financial Bureau, which are part of its Administrative and Financial Reorganization Plan, strengthening its new public policy role.<br>(iii) Design and implementation of a mechanism to monitor municipal finances, which will allow ongoing monitoring of DAAFIM and will serve as an input for the Public Credit Bureau and for INFOM.<br>(iv) Establish a methodology to quantify the municipal debt stock. | Improved municipal debt management. |

| Objectives | Tranche I | Tranche II | Outcomes |
|---|---|---|---|
| | | **Means of verification**:<br>(i) Copy of the Ministerial Resolution approving the organization and function manual of the Office of the Minister of Finance and the DAAFIM Resolution approving the process and procedure manuals.<br>(ii) Resolution of approval by the INFOM Board of Directors.<br>(iii) Independent consultant's report. | |
| **IV. Medium-term fiscal programming and results-based management** | | | |
| To strengthen budgetary capacity and begin results-based management. | Update of the Public Expenditure and Financial Accountability Report, prepared by MINFIN in coordination with Multilateral Financial Institutions.<br>**Means of verification**: Independent consultant's report. | (i) Preparation of the Medium-term Fiscal Policy Framework (three years), including an analysis and guidelines for national and municipal borrowing, posted on the MINFIN website, as part of preparation of the 2014 Budget Act.<br>(ii) Implementation of pilot plan for results-based management in the Ministry of Public Health and Social Assistance, which is a key part of the Social Inclusion strategy focus under the government's 2012-2016 program.<br>**Means of verification**:<br>(i) MINFIN website.<br>(ii) Independent consultant's report. | Improved policies on borrowing, budgeting, and expenditure management control. |