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GUATEMALA

Recent Economic Developments—Supplementary Information

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Approved by Western Hemisphere Department

May 12, 1998

Contents

Page

Text Box

Figures

Tables

I. SOCIAL AND INSTITUTIONAL EXPENDITURES OF THE PEACE PROGRAM

A. Introduction

1. Following the signing of the Peace Accords in December 1996, the Guatemala government outlined a peace program containing major initiatives in the areas of health, education, land reform, housing, and the justice system. The peace program is being implemented with substantial donor support. The major areas of the program are reviewed below for the period 1998–2000, based on discussions with the authorities of executing ministries and agencies during the 1997 Article IV consultation, as well as with staff from the U.N. Verification Mission (MINUGUA), UNDP, IBRD, and IDB. With the exception of specific goals set out in the peace accords, program targets in the various areas for 1998–2000 continue to evolve, with the result that discrepancies may exist among different sources. In this section, the latest targets from government sources have been used.[1]

2. There are three common threads in the peace related expenditure programs: (1) **expansion in access to services**, especially to the poor, indigenous rural population, (2) **decentralization**, with an emphasis on community and private sector participation in service delivery and (3) **economy,** through improved financial management, contracting out, and competitive procurement practices.

B. Education

a. The problem

3. Guatemala's illiteracy rate is approximately 44 percent (1995), the second highest in Latin America. **Illiteracy** is much higher in the predominantly **rural departments** (around 65 percent) where the indigenous population is more heavily concentrated than in Guatemala City (16 percent) and is much higher for women (46 percent) than for men (33 percent).[2]

4. **Net primary school enrollment** in 1995 was 68 percent and **net pre-primary enrollment** was 20 percent. Enrollment rates are much lower in rural than in urban areas and for girls than for boys. The global **repetition and desertion rates** for primary school are estimated at 15.0 percent and 8 percent, respectively.

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[1]For a complete detail of sources see the reference list at the end of this Appendix.

[2]World Bank, World Development Indicators, 1997; IDB, Loan Proposal for a Project to Support Education Reforms, October 28, 1998 (GU-0037).

b. Main objectives and programs

5. For 1998–2000, the **main objectives** are the expansion in access to primary education, decline in desertion rates, and the increase in adult literacy (Table 1). The **main programs** are: (1) the expansion of a new model of community and parent managed primary schools in rural areas *(Programa Nacional de Autogestión para el Desarollo de Educación*—PRONADE); (2) the increase in public investment in rural schools by the social funds, *Fondo de Inversion Social* (FIS) and *Fondo Nacional para la Paz* (FONAPAZ); and (3) the increase of schools and teachers offering bilingual education, teacher training, and girls' education. Most of these programs are supported by projects of the World Bank, IDB, and bilateral donors.

6. The **PRONADE program** represents a major departure from the traditional centralized model of primary school management. In this program, funds are transferred directly to community education councils (*Comités Educativos de Autogestión*—COEDUCAs). The COEDUCAs hire teachers, monitor teacher performance and can base contract renewal on performance. PRONADE also contracts with public or private entities, principally NGOs, to organize, train and provide advisory services to the COEDUCAs and to train teachers. PRONADE encourages bilingual education by providing teacher training, textbooks, teacher guides and mini-libraries in the Spanish and Mayan languages.

7. The **bilingual educational programs** train teachers and develop teaching material in the 23 indigenous language groups with texts to be printed in four major indigenous languages beginning in 1998, and in 8 additional indigenous languages in 1999. The **pre-primary education programs** ease the transition from indigenous languages to Spanish. The **education for girls** program uses a publicity campaign to promote the benefits of education for girls among the indigenous population. Texts are being reviewed to eliminate the stereotyping of the roles of women and girls in society. A **school attendance promotion program** provides breakfast and a nutritious snack as incentives to attend primary schools, with emphasis on rural areas. The program is slated to expand to 700,000 pupils in 1998 from 300,000 in 1997. A strengthened **teacher training program** is emphasizing training in such areas as multi-grade education, the development of curriculum guides and the dissemination of best techniques through "quality circles" that are attended by the majority of primary school teachers.

8. The **specific goals for the year 2000** are an expansion in the coverage of PRONADE schools by 250,000 (from 100,000 in 1997); an improvement in the literacy rate to 70 percent and in the primary school net enrollment rate to 80 percent; and large percentage reductions in repetition and desertion rates.

Table 1. Main Education Sector Programs/Goals, 1998–2000[1]

Cumulative

Programs/Goals	Status in 1995	Est. 1997	Proj. 1998	Proj. 2000
Expansion in access				
Enrollment in PRONADE primary Schools	0	100,000	153,000[2]	250,000
FIS/FONAPAZ school construction Number of classrooms	...	1,240	3,740	7,800
Increase workers training Number of workers	...	...	...	200,000[3]
Improvement in quality				
New bilingual education programs: Teacher training and material			4 major indigenous languages	12 indigenous languages (at least)
New teacher training programs in non-PRONADE schools Percent of teachers			70	85
Adult literacy programs			expand	expand
Girls education program			expand	expand
Expanded pre-primary education Number of centers	2,550 (1996)	3,000	4,000	6,000
Goals		(In percent)		
Primary school net enrollment rate	68.2	71.0	...	80.0
Illiteracy rate	44	39.0	...	30.0[3]
Primary school desertion rate	8.2 (1996)	...	...	5.4
Primary school repetition rate (percent)	15.3 (1996)	...	...	10.0

Source: Ministry of Education.

[1]Targets based on information provided by the Ministry of Education, or presented in specific projects by the World Bank and the IDB.

[2]Presented in the 1998 Budget.

[3]Target of the peace accords.

c. Progress during 1997 and some problems of implementation

9. In November 1997, legal status was granted to the COEDUCAs, thus enabling PRONADE to transfer to them budget funds. About 100,000 students were incorporated in the PRONADE delivery system during 1996–97. Through the FIS and FONAPAZ programs, over 1200 rural class rooms were constructed, most of which were related to the PRONADE program. An additional 450 pre-primary education centers were established in 1997. During 1997, the new departmental directors of education were selected. Also, in 1997, the Universidad del Valle was contracted to develop criteria for evaluating and monitoring the decentralized education programs. Limited progress was made in the expansion of adult literacy programs.

C. Health

a. The problem

10. Life expectancy at birth is 65 years, infant mortality rate is 44 per 1,000 live births and maternal mortality is 46.4 per 10,000 live births.[8] Health conditions are poor among indigenous population, groups with lower education and income levels and residents of rural areas. More than 64 percent of total deaths in the country are caused by infectious, nutritional and perinatal diseases. The main causes of infant mortality could be prevented through basic sanitation and immunizations.

b. Main objectives and programs

11. For 1998–2000, the main objectives are: (i) decentralization and expansion in access to public health services in the rural areas, and (ii) substantial reductions in infant and maternal mortality rates. The main programs are: (i) community based projects to deliver basic health services to rural areas by private contractors (*Sistema Integral de Atención en Salud*—SIAS), (ii) community based water and sanitation projects undertaken by FIS and FONAPAZ; (iii) decentralization of public health care management; (iv) the introduction and expansion of competitive procurement; and (v) the rehabilitation of existing health posts, centers and hospitals (Table 2).

12. The **SIAS program** delivers a basic package of mainly preventive health services. These services emphasize pre- and post-natal care for women, disease prevention and nutrition for children, environmental health and referrals and emergency assistance to the population at large (Table 3). SIAS services are provided by private sector groups that have contracted with the Ministry of Public Health. The service contractors provide the basic health service package and register the number and names of the individuals served, and the nature of

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[8]World Bank, World Development Indicators, 1997.

the service provided. This information, along with site visits and consultations with the communities being served, provides the basis for program supervision.

13. The communities provide a site (typically a church) for the provision of services. While the initial contracts were between the Ministry and the service providers, the goal is to involve directly the community in the contracting and service evaluation processes. The ministry estimates that the SIAS package will cost US$6 per person as compared with US$10 per person if it were delivered by the Ministry itself in a traditional public health post or center.

Table 2. Main Health Sector Programs/Goals, 1998–2000[9]

Programs/Goals	Status in 1995	Level in Est. 1997	Proj. 1998	Proj. 2000
Coverage of rural population with SIAS Program	5 million uncovered	4.3 million uncovered	3.2 million uncovered[2]	1.2 million uncovered (or 3.8 million reduction in uncovered population)
Water/sanitation projects in Rural areas		300 new projects	300 new projects	900 projects during 1998–2000
Decentralization of health care Management		20 percent complete	40 percent complete	100 percent complete
Introduction of competitive Procurement		list of 102 basic generic medicines	expansion	expansion
Infant mortality	44 per 1000[3]	40	36	50 percent reduction from the 1995 official level.[4]
Maternal mortality	28.4 per 1000[3]	26	23	50 percent reduction from the 1995 official level.[4]

Source: Ministry of Public Health.

[9]Most of the specific targets are based on information provided by the Ministry of Public Health.

[2]According to the 1998 budget, which is in agreement with the SIAS goal, the target is to increase coverage by 1.1 million people.

[3]1995 data based on World Development Indicators. Official estimates may differ.

[4]As presented in the peace accords.

Table 3. SIAS—Basic Health Service Package

Women • pre-natal care • attention at birth • post natal care • referrals	**Children** • vaccination • control of diarrhea and cholera respiratory diseases • nutrition • referrals
Population in general • attention to the sick • emergencies • prevention of sexually transmitted diseases • referrals	**Environmental health** • potable water • sanitary waste disposal • housing

Source: Ministry of Public Health.

14. Through the **decentralization program** ministry offices and personnel are being transferred to the geographic Departments and Districts where public health programs would be managed. Each department is responsible for monitoring and reporting on ten key health indicators, including the target indicators for national goals. The **competitive procurement program** for medicines, medical equipment and vehicles replaces a mainly single source procurement system that had become a major source of corruption. Programs of the **FIS and FONAPAZ** cover a wide variety of health and health-related projects: water and sewerage piping; construction of latrines, wells and health posts; equipping of health posts and training and equipping of community health personnel.

15. The **specific goals for the year 2000** are to reduce the rates of infant and maternal mortality by 50 percent and to provide preventive health services coverage to an additional 3.8 million people (5 million people did not have access in 1995). Public health management will be fully decentralized to the departmental level by 2000 with systems in place to evaluate performance.

c. Progress during 1997 and some problems of implementation

16. In the **SIAS program**, through November 1997, 16 contracts for the provision of the basic health package were signed, covering more than 600,000 people in areas of rural departments that had not previously been served by public health services. The service providers were principally NGOs and churches. An additional contract covering 260,000 people was signed with the Social Security Institute (IGSS). Through the FIS and FONAPAZ programs, about 300 small scale health related projects were undertaken with approximately 300,000 beneficiaries.

D. Justice System

a. The problem

17. The justice system (the Judiciary, Public Prosecutor, Police and Public Defender) is characterized by deficiencies in availability and quality.

- **Availability:** In 1996, one third of Guatemala's 331 municipalities lacked a justice of the peace (*Juzgado de Paz)*, the lowest rung in the court system. Even fewer were served by an office of the public prosecutor and none was served by a public defender. Civilian police were absent in the majority of communities. The language of the justice system is Spanish and no assistance is provided to the substantial population for whom Spanish is a second language. The administrative support system is highly centralized, with no regional offices.

- **Quality:** A study of a sample of 500 past cases[4] decided by the court system found serious deficiencies in the quality of the decisions that were reached by the judiciary, particularly in the areas of the treatment of evidence and the reasoning behind the decisions reached. Few crimes were ever prosecuted or solved and criminals regularly escaped from jails or were released without apparent justification. Corruption also is an important issue.

b. Main objectives and programs

18. For 1998–2000, the **main objectives** are significant improvements in access to and quality of the justice system. Improved access will concentrate on rural areas. The **main programs** are aimed at: (i) creating and training the national civilian police force which is replacing the police provided by the army; (ii) creating and expanding justice system personnel, courts and public defenders in rural communities; (iii) creating a career civil service for judges; (iv) expanding and improving training programs for the police, public prosecutors and judiciary system personnel; and (v) providing special assistance for indigenous language speakers (Table 4).

19. Among the **specific goals for the year 2000** are (i) a civilian national police force numbering 20,000; (ii) a fully operational career civil service in the judiciary; (iii) an expansion in the number of judges (mainly justices of the peace in rural communities) and first instance courts; (iv) an expansion in the number of public defenders; and (v) fully operational regional offices for the evaluation and supervision of judges and other judiciary system personnel (including for administrative offices).

20. A pilot Center for the Administration of Justice (CAJ) was set up in Nebaj (in the Department of Quiché, North of Guatemala City and one of the former war zones) in 1996

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[4]*Plan de Modernization del Organismo Judicial 1997–2000, Corte Suprema de Justicia y Organismo Judicial,* August 1997.

with the assistance of MINUGUA and FONAPAZ to provide an experimental program for justice administration in an single locale. The CAJ model consists of : (i) a judge; (ii) a public prosecutor; (iii) an office of the public defender; (iv) a police substation; and (v) an office that provides free legal advice and services in the languages of the community. The Nebaj pilot may be replicated in about 18 other rural communities in 1998–2000. A second pilot program involves the testing of community based conciliation as an alternative to formal dispute settlement through the courts.

Table 4. Principal Justice Sector Programs/Goals, 1998–2000

Programs/Goals	Change in Status in 1995	Est. 1997	Proj. 1998	Cumulative 1998– 2002
Access to justice				
Administrative decentralization and expansion of courts				
Construction of courts: (justice of peace courts, regional justice centers, special justice centers in resettlement areas)		...	50	244–262
Expansion in:				
(I) number of judges	497		20	110–130
(ii) civilian police	0	...	2500	20,000
(iii) public defenders	20		20	80
New dispute settlement mechanisms	0			15
Improvements in justice quality				
Career judicial service established		law intro-duced in congress		law implemented
Training of judicial personnel (3500 persons trained twice each year)			7,000	35,000
Performance evaluation systems implemented, including setting up an anti-corruption commission			offices set up in each branch of judicial system	
Reduction of armed forces (no police function)		15,000	unspecified	1/3 of 1995 level

Source: Information provided by the Ministry of Justice, Ministry of the Interior and the Supreme Court.

c. Progress during 1997 and some problems of implementation

21. In 1997, two commissions were set up to make recommendations for improving the justice system. The Commission for the Strengthening of the Justice System, which covers the justice system as a whole; and the Commission for the Modernization of the Judiciary, which covers only the Judiciary. These commissions held public hearings and workshops at which invited participants from within and outside the justice system were asked for their views on the state of the justice system and key areas for improvement. Based on the work of the commissions, the Judiciary, the Public Prosecutor and the Police issued a formal letter of intent to work together to reform the justice system.

22. In September 1997, the Judiciary Commission published a master plan for reform of the judicial system, laying out the problems and a calendar for a set of actions. The report and recommendations for the Justice System Commission was published in April 1998. In an interim report published in September 1997, the Justice System Commission commented favorably on the proposed law that the legislature was considering for reforming the public defender system.

23. Problems with implementation need to be resolved in order to meet the targets and calendar for improving justice services. In 1996 and 1997, only about 72 percent of the budget of the Judiciary was executed. In 1997, one out of every five of positions authorized in the budget for the Judiciary was not filled. One of the studies carried out under the Judiciary Commission found that 30 percent of the administrative personnel in the judiciary did not meet minimum requirements for the positions they held. Pay scales for the new civilian national police force may not be sufficiently high to attract the quality of people needed, and training programs will be important to sensitize the police to issues in human and property rights.

E. Land

a. The problem

24. There are two main elements to the land problem: (i) uncertain legal status of the land under occupation; and (ii) substantial numbers of people either without land or on uneconomically small plots. Many of those without land were displaced from their land by the civil war.

- **Land distribution**. The top 2.5 percent of Guatemala's 5.3 million farms control 65 percent of the agricultural land. The average size of these farms is 200 hectares. In contrast, the bottom 88 percent of Guatemala's farms control 16 percent of the cultivated land with an average farm size of 1.5 hectares. Estimates of the number of families displaced by civil war range upward from 50,000.

- **Legal uncertainty**. An estimated 95 percent of rural properties is not registered. Moreover, ownership status of much of the registered rural land is in doubt because it is not occupied by the legally registered owner.

b. Main objectives and programs

25. For 1998–2000, the **main objectives** are: (i) clearing up the uncertainty surrounding land tenure, and (ii) expanding the class of owner occupied farmers. The **main programs** are: (i) a national land titling and registry modernization program; (ii) a market-assisted land reform program; and (iii) a simplified land tax (Table 5). The land titling program involves a four step process: (i) a mapping out of property boundaries; (ii) a process to resolve conflicting boundary and ownership claims; (iii) the titling of the land; and (iv) the modernization and decentralization of the land registry system. The Department of Peten is serving as the pilot project for the land titling program.

26. **The market-assisted land reform program** finances the purchase of land and collateral investments for eligible groups. Land is purchased by the government's land fund (*Fondo de Tierras*) from a private sector seller. The group acquiring the land becomes indebted to the *Fondo*. The *Fondo* qualifies the social eligibility of the group, with preference given to those that have been displaced by the civil war. Under its internal guidelines, it rejects any project proposals that are not financially viable, involve land for which there is no clear title, and/or have per family cost in excess of Q35,000 (about US$6,000).

27. **Specific goals for the year 2000**. Because of the estimated five-year period for completion for all phases of the land registry and titling program, it will take until 2002 for Peten to complete the titling phase. With four additional departments scheduled to begin the process in 1999, these departments would complete the titling phase in 2003. All 22 departments would have completed the program by 2006.

c. Progress during 1997

28. In 1997, the government set up an inter-ministerial committee (PROTIERRA) for the design and management of all issues related to land tenure questions. In negotiation with interested donors, the World Bank agreed in principle to support the pilot project for titling Peten. Bilateral donors agreed to support the land titling process in other departments, with the World Bank helping to develop common procedures for the titling in the different departments. During 1997, land records were fully computerized for Peten and partially computerized in two other departments (El Progreso and Sacatepequez). The legal changes required to modernize and decentralize the land registry were developed by the government in 1997 and are expected to be submitted to the legislature and approved in 1998.

Table 5. Principal Land Sector Programs/Goals, 1998–2000

Cumulative Changes

Programs/Goals	Est. 1997	Proj. 1998	Proj. 2002	Proj. 2003–2006
Coverage of nation with clear land titles				
(I) Cadastre phase completed Number of departments		1	22	22
(ii) Dispute settlement phase completed Number of departments			4	10 in 2003 16 in 2004 22 in 2005
(iii) Title registration phase completed Number of departments			1	4 in 2003 10 in 2004 16 in 2005 22 in 2006
(iv) Registry modernization and decentralization Percent of departments	10	20	100	100
Families assisted in acquiring land	1,000	4,000	16,000	32,000

Source: Fondo de Tierras; and Ministry of Agriculture.

F. Urban Housing

a. The problem

29. The majority of families that live in owner occupied dwellings do not hold formal legal title to the land. In Guatemala City, about 70 percent of families are without such legal titles. The quality of housing is low. There are 2.3 persons per room in Guatemala as compared with a Latin American average of about 1.5 persons. About 42 percent of the households have access to piped water in their households. Of those without access to piped water, 20 percent obtain their water from rivers or lakes. About 30 percent of households are not connected to sanitary waste disposal systems.

b. Main objectives and programs

30. For 1998–2000, the **main objectives** for the housing sector are: (i) the expansion of low and middle income urban housing; and (ii) the regularization of legal titles to a significant portion of the illegally occupied urban land. The **main programs** are: (i) a housing subsidy program; and (ii) a package of legal and regulatory reforms designed to promote the

development of a market in low cost urban land. The **specific goals for the period 1998–2001** are the regularization of 41,000 titles to urban properties that formerly were illegal and the production of 41,000 housing solutions (Table 6).

Table 6. Principal Housing Sector Goals, 1998–2000

Goals	Est. 1997	Proj. 1998	Cumulative 1998–2001
Regularization of legal title for pre-1995 illegal housing	0	3,000	41,000
Low (L) and middle (M) income housing solutions	2000 M units produced	7,500 (3750 L) (3750 M)	45,000

Source: Ministry of Planning (SEGE PLAN); and IDB.

31. The **housing subsidy program** provides a grant to eligible households through the Guatemalan Housing Fund (FOGUAVI). FOGUAVI, in turn, receives its funds via transfers from the central government budget. For **middle income households**, the financing is provided on market terms by the private sector, with the government providing funds to reduce (buy down) the mortgage. Eligible households will be required to provide a substantial contribution in cash. For **low income households**, the program consists of cash grants for community-wide upgrading projects in low income neighborhoods and, for individual homeowners, matching cash grants that permit low income households to improve their homes. This component of the program relies on NGOs for assistance in project development and appraisal.

32. Existing laws governing land markets require too expensive zoning standards, which raise the price of legally registered land for low income households to prohibitive levels.[5] These expensive regulations have fostered illegal settlements and the absence of land titling. The **urban land market reform program**: (i) changes existing housing codes to permit private landowners to legally subdivide and title land with a minimum of zoning standards. Subdivision preparation would be kept to minimum, e.g., the drilling of a well and the laying out of plot sites. The titled land is then used as the basis for obtaining loans for housing improvements; and (ii) provides title to land in existing neighborhoods located on invaded public lands. Public land is transferred to private use with expedited procedures to obtain individual, registered title to the lots.

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[5]The costs involved in meeting these requirement are estimated at the equivalent of 18 months salary of low income household.

c. Progress during 1997 and some problems of implementation

33. In September 1997, initial modifications were made to the Law on Housing and Human Settlements to create a legal basis for low income housing. In October 1997, reforms were made to the "Temporary Law on the Legalization of State Land Occupied by Low Income Housing" that will permit municipal lands to be granted to families in extreme poverty. In October 1997, the IDB approved a loan that will support the government's housing program.

34. A number of elements in the housing program remain controversial. The political group of former combatants (URNG) claims that the subsidy provided by the program to expand housing is too small for low income families. The URNG also expressed disappointment at the slow pace of the housing subsidy program.

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II. THE TAX SYSTEM [6]

A. Introduction

35. This section describes Guatemala's tax system and provides recommendations to improve its efficiency and bouyancy. The Peace Accords call for an increase in the tax effort from abut 8 percent of GDP in the base year 1995 to 12 percent of GDP by 2000. This would require strengthening tax policy and tax administration.

36. During the period of 1970–1997, Guatemala's tax ratio averaged 8 percent of GDP, with a maximum value of 10.3 percent in 1978 and a minimum of 5.7 percent in 1984 (Figure 1). A number of tax reforms implemented failed to increase the tax ratio on a permanent basis. Generally, the reforms were too timid, and several measures were repealed by the courts on constitutional grounds after appeals by the powerful business sector traditionally opposed to tax increases.

37. Over the past two years, the authorities have strengthened their efforts to find ways to increase tax revenues, as called for by the peace accords. In early 1996 the VAT rate was raised from 7 to 10 percent, which combined with a temporary tax on gross income, increased the tax ratio by 2 percentage points of GDP to 8.7 percent of GDP (see box for details). In May 1997, the authorities introduced changes to the income tax law, including an increase in income sources subject to tax withholdings (although combined with a reduction in the maximum rate), and in late 1997 a new tax package was approved by congress, which included the extension of the tax on gross income through May 1999, higher excises, and the repeal of several laws granting specific exemptions to the VAT, income tax and import tariffs.

B. Main Features of the Tax System

38. Guatemala's tax system is characterized by its low capacity for generating revenues. Low tax rates and a narrow tax base because of wide exemptions and deductions (some included in the Constitution),[8] reduce the **potential** tax yield. Widespread evasion resulting

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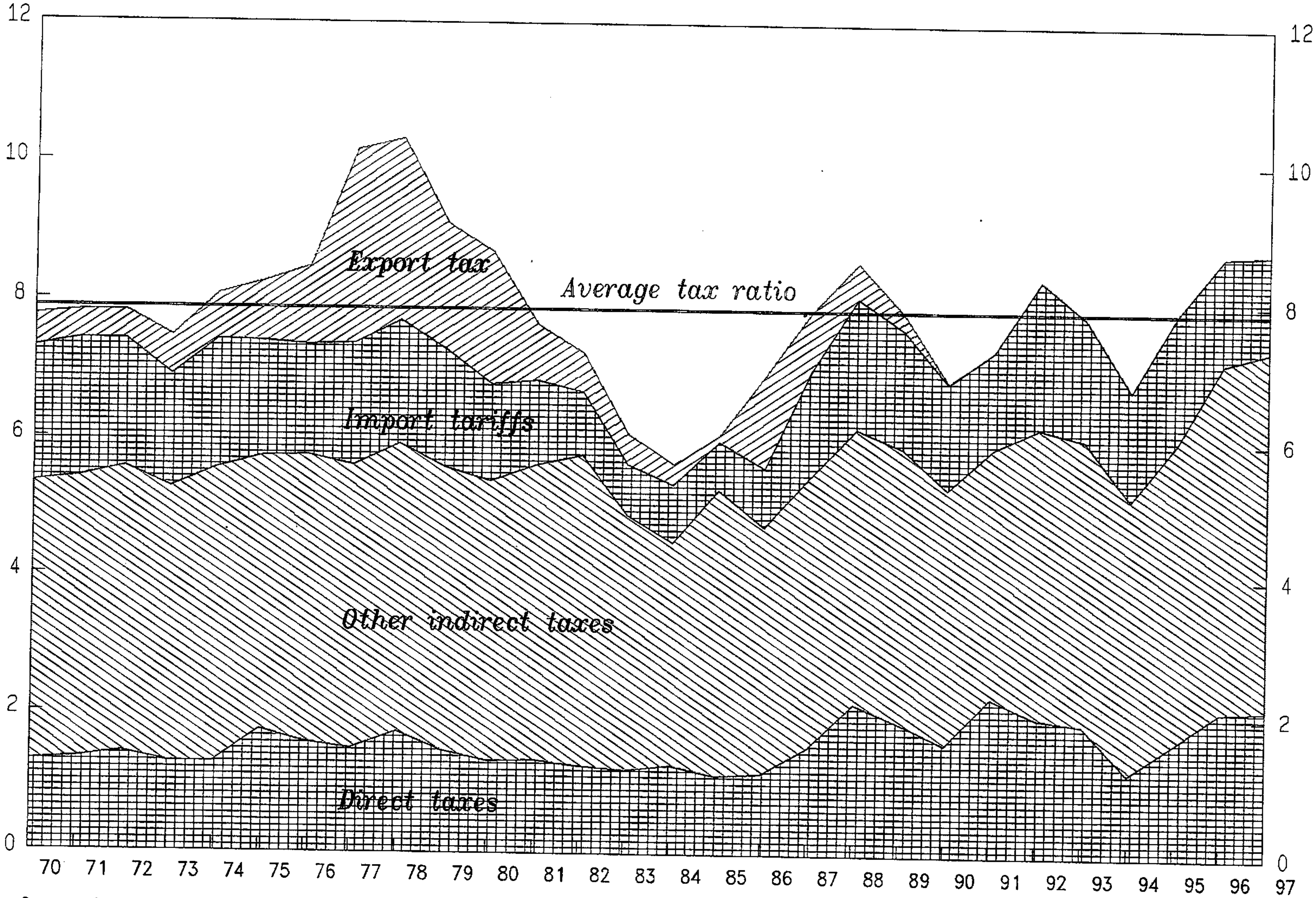
[6]Most of this section is based on the reports prepared by several technical assistance missions to Guatemala from the Fiscal Affairs Department of the Fund, particularly M. Cassanegra de Jantscher, P. Castro, A. Ramos and O. Schenone, *Guatemala: Rompiendo la Barrera del 8 Por Ciento*, IMF, Fiscal Affairs Department, May 1997; and P. Shome, J. Escolano, and E. Haindl, *Guatemala: Mejora de la Estructura y Productividad del Sistema Tributario*, IMF, Fiscal Affairs Department, May 1994.

[8]In addition to the exemptions included in each tax law, there have been exemptions granted by special laws to selected activities. Several of those exemptions were eliminated by the law for the elimination of exemptions and deductions (Table 7).

Figure 1. Guatemala:
Tax Revenue by Categories
(In percent of GDP)



Sources: Central Bank of Guatemala; and Fund staff estimates.

Developments in the Guatemalan Tax System During 1991–97

1991–92

- **VAT**. (i) reduction of the list of activities and institutions exempted; (ii) elimination of the zero rate for a group of products.
- **Income tax**. (i) reduction of the tax brackets for individuals (from 16 to 3), reduction of the maximum rate from 34 to 25 percent, increase in the exempted personal income and introduction of a tax credit for VAT up to 7 percent of personal net income; (ii) establishment of a 25 percent flat rate for corporations.
- **Excises**. Change in the tax on petroleum products from ad-valorem to specific.
- **Stamp tax**. Transfer of activities to the VAT base and elimination of the stamp tax on bank credits.

1994. The Constitutional Court revoked quarterly income tax payments. Later congress approved a tax package including:

- **VAT**. (i) increase in the rate from 7 to 10 percent (attached to the signing of the Peace Accords, it became effective in January 1996); (ii) revision of the system of tax credit returns.
- **Income tax**. (i) widening of the tax bracket limits for individuals, and increase in the maximum rate to 30 percent; (ii) increase in the rate for firms to 30 percent; (iii) reinstatement of quarterly tax payments; (iv) changes in the rates applied to tax withholdings, including those on interest income from certain financial assets; and (v) a minimum tax of 1½ percent on gross assets.
- **Tax administration**. Changes in the penal code to make tax violations subject to imprisonment.

1995. In early 1995 the Constitutional Court suspended: (i) some of the modifications to the penal code introduced in 1994 (ii) income tax withholdings on certain activities, including interest income; (iii) the tax on assets. To compensate, in April congress approved new legislation including: (i) a 1½ percent tax on assets, but on a net basis (the concept of a minimum income tax was lost with this new definition); (ii) the reestablishment of the 10 percent withholding tax on interest income.

1996

- **ISET or tax on gross income/assets**. To be applied in 1996–97, as follows: (i) in 1996, the lower of 1 percent tax on gross income or 1½ percent on assets for individuals and corporations, **to be deducted** from the income tax base; (ii) in 1997, a 1½ percent tax on gross income or 2 percent on assets **to be credited** against the income tax. Half of the revenues obtained from the ISET were to be deposited at the central bank.
- **VAT**. (i) introduction of a special regime for the monthly refund of tax credit to exporters and mechanisms to expedite the process; (ii) minor changes in exemptions.
- **Tax code**. Increase in penalties and possible closure of business after two infractions.

1997

- **Income tax**. (i) gradual reduction in the maximum tax rate from 30 to 25 percent (1998–2000); (ii) increase in income sources subject to tax withholdings; (iii) increase in the minimum exempted personal income, and in the maximum credit for VAT (to 10 percent of income); (iv) reduction in the loss carry over period to two years.
- **Tax package** (approved in December 1997) including:

(i) **IEMA**: a 1.25 percent tax on gross income or 2 ½ percent on assets of enterprises, credited against the income tax with a one year lag, in place until May 1999 (equivalent to an extension of the ISET).

(ii) increases in the **tax on gasoline** (by about US$0.17 per gallon), **sea, land and air departure tax** (100 percent), and in **the taxes on beverages**.

(iii) **elimination of specific laws establishing exemptions** on the VAT, income tax and import tariffs.

The package also included an increase in the rates and in the base of the property tax, that were repealed later by congress after popular rejection and the suspension of some of its articles by the Constitutional Court.

from a weak tax administration and deficiencies in the legal and regulatory framework further lower **effective** collection.

39. Guatemala's tax system currently is based primarily on the VAT, the income tax, few excises, and the import tariffs. The VAT and the income tax (including the tax on gross income/assets) provided about 66 percent of tax revenues in 1997 (or 5.8 percent of GDP). Lower import duties reduced customs revenue from about 30 percent of tax revenue in 1970–89 to 16 percent in 1997. Excise taxes provided about 13½ percent of tax revenue (1.2 percent of GDP), and comprise beverages, tobacco, and petroleum derivatives. Other minor taxes include a tax on oil production (*regalías)*, a stamp tax, a tax on vehicle circulation, and a property tax which is transferred to the municipalities.

a. The value-added tax

40. The VAT provides 42 percent of tax revenue (3.7 percent of GDP) (Figure 2). Since its introduction in 1983 several reforms have improved the productivity of the VAT,[9] but problems remain, including a low rate—10 percent (among the lowest in Latin America), many exemptions that erode the base and complicate its control, a special treatment for imported products that excludes tariffs from the base, and deficient administration (Table 8).

41. The productivity of the VAT increased during 1984–95 from about 0.2 percent of GDP to 0.4 percent in 1995, because of a broader base and improvements in collection, although it declined slightly (to less than 0.4 percent) after the rate increase in 1996. This level of productivity for a low VAT rate suggests the need for further improvement.[10] Several exemptions in the VAT are equivalent to a zero rate regime.[11] Moreover, exemptions are related to the **subject** of the transaction and not to the **object**, which complicates its control; thus, one product may have different treatment depending on who is selling it.

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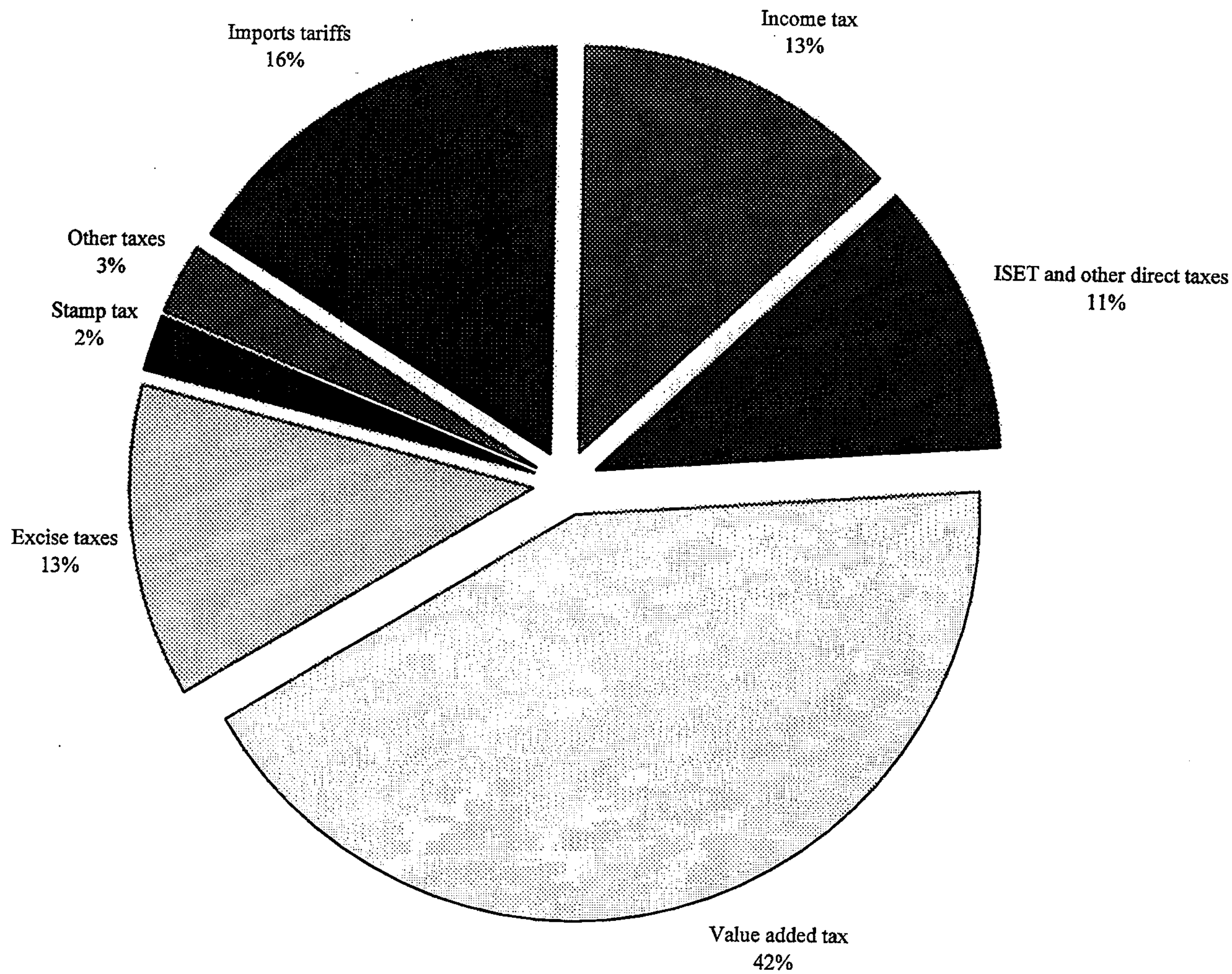
[9]The productivity refers to the percentage to GDP effectively collected per each percentage point of the tax rate.

[10]Based on FAD calculations, VAT collection could be at around 60 percent of its potential base, or 6 percent of GDP, compared with an actual collection of 3.7 percent of GDP. These calculations use estimates presented in P. Shome, et. al, IMF, Fiscal Affairs Department, May 1997.

[11]There are two groups of exemptions in the VAT law: general and specific. The **general exemption** regime includes activities which do not pay VAT on their purchases. The sectors or activities favored with the **specific exemption** regime do not charge VAT on their sales, in addition of being exempt from VAT on purchases. This regime is identified as the "zero rate regime".

Figure 2. Guatemala:
Tax Structure, 1997
(In percent of total tax revenue)



Sources: Central Bank of Guatemala; and Fund staff estimates.

42. The system of tax credits has confronted several problems. Before 1997, activities/enterprises favored with the zero rate regime had to follow a highly complicated claiming process to receive refunds in cash or in tax certificates, and there was a large accumulation of submitted claims. Since March 1997, a new system allows registered exporters to claim cash refunds almost immediately with a *posteriori* verification, eliminating the backlog of claims. With the new system there has been an increase in the gross receipts of the VAT and in cash refunds, with the net yield remaining about unchanged.

b. The income tax

43. The income tax law has been subject to a number of reforms and counter reforms by the courts, introducing a high degree of variability in its yield. In 1996–97 a temporary tax on gross income/assets (ISET) was introduced (see box). The combined yield of the ISET and the income tax was about 23 percent of tax revenues (2.0 percent of GDP).

44. Data on **income tax on individuals** are not reliable, but rough estimates indicate that it may not be higher than 20 percent of total income tax. This relatively low yield would be explained by the substantial deductions applied to calculate net taxable income, possibly making this tax cost ineffective (revenue lower than collection costs). Considering all deductions and credits, it has been estimated that less than 10 percent of the work force are in the income tax base.

45. The tax base for **enterprises and individuals operating independently**, is equal to profits. The tax rate, 30 percent in 1998 (scheduled to be reduced to 25 percent effective in mid-1999) can be reduced to 24 percent (20 percent in 1999) by the deduction of reinvested profits. The norms for depreciation are in line with regional standards, and the period for carry over of losses was reduced from four to two years in 1997. Although improvements have been introduced, some problems remain, including: (i) a number of exemptions e.g., (maquila and tourism developments); and (ii) extensive deductions (including for investments in the construction of housing, schools, hospitals and recreational facilities made available to workers) (Table 9).

46. Problems related to the amount of exemptions/deductions, could be compensated with a **minimum income tax**. An equivalent to this tax, the ISET was introduced in June 1996 for a two-year period, and extended in December 1997 as a new tax, the IEMA until May 1999. The ISET/IEMA applies to gross income or assets of enterprises. If the IEMA were to be made permanent it could yield 0.4–0.5 percent of GDP a year, leading to a combined income tax revenue of around 1.8–2.0 percent of GDP.

c. Excises

47. Excise taxes include taxes on petroleum derivatives (which represents almost three-fourths of all excises), beverages (alcoholic and nonalcoholic), and tobacco. Taxes on **petroleum derivatives** are applied per gallon of consumption (including imports), and range from the equivalent of less than US$0.10 per gallon of regular gas, kerosene and other derivatives to US$0.60 per gallon of superior gasoline. Exemptions include all individuals/enterprises or agencies exempt by the Constitution, international agencies, and electricity generation for public consumption. Taxes on **beverages** are set as a percentage of the wholesale price, which according to the law is to be revised every year in line with the price paid by the final consumer. Taxes on **cigarettes** are set at 100 percent of the sales price; for other **tobacco products** a specific tax ranges from the equivalent of less than US$0.10 per kilogram to US$0.20 per kilogram.

d. Property tax

48. This tax affects land and construction as well as property and donations received from wills. More than 75 percent is transferred to the municipalities. This tax has a very low yield (less than 0.1 percent of GDP) because of low rates, exemptions, outdated valuation of property and weak administration.

e. Import tariffs

49. In 1997 customs revenue represented about 16 percent of tax revenue, with an effective tariff of 6.6 percent of imports (1.4 percent of GDP), compared to 19 percent in 1991 with an effective tariff of 7 percent. Problems in customs administration also have affected revenue. Differentiated tariffs and discretionality by the customs office have permitted a high degree of evasion.

g. Tax administration

50. There are serious deficiencies in tax administration arising mostly from poor institutional arrangements and an inefficient regulatory framework for tax enforcement. The institutional problems are present in detection, collection, and audit procedures. In addition, the regulatory framework does not facilitate an effective administration of sanctions.

51. The 1997 FAD mission stressed the following major problems: (i) preventive detection has a low coverage; on-site audits consume a substantial amount of time per taxpayer (about six months); (ii) human resources and equipment are not adequate for the task; (iii) priorities are not based on cost effectiveness: too much emphasis is given to the income tax, instead of the VAT (less than 2 percent of VAT taxpayers are subject to inspection/audit every year); (iv) the cross-checking of information is ineffective.

52. Several modifications have been introduced in the tax code and in the penal code to raise **sanctions** for tax evasion,[12] but there are areas that require stiffer penalties. Internal norms limit penalties to only 20 percent of tax liabilities for delays in payment, not filing tax forms, and not issuing the required documents. In addition, the temporary business closure is only imposed at the second violation. In the area of **tax collection**, the auditing of tax compliance does not separate major tax payers from the rest, resulting in long delays in the application of corrective measures for cases that could have high productivity.

The SAT

53. In January 1998, congress approved a law that permits the creation of the Superintendency of Tax Administration (SAT). The SAT combines the internal revenue unit and customs administration, and its main objective would be to manage all procedures related to collection, supervision, auditing, and application of sanctions. The SAT would be a decentralized entity with autonomy to operate in all fronts related to its functions, including personnel policy. Its main source of income would be 2 percent of collected revenue. A unit for "special taxpayers" (major taxpayers) would be created within the SAT. According to the authorities the SAT is to be fully operational in 1999.

C. Actions Needed to Improve the Tax System on a Permanent Basis

54. A serious reform of the Guatemalan tax system should aim at increasing tax revenue on a permanent basis, at least to the level envisaged in the peace accords. The continuous changes in tax legislation, including the succession of temporary taxes do not create a favorable environment to attract investments. In addition, the wide range of tax exemptions and deductions, some with direct impact in the allocation of resources, erode the tax base and weaken tax administration.

55. Following FAD recommendations,[13] an ideal tax system should be simple, based on few taxes, easy to administer and control, and with a low distortional impact in terms of allocation of resources. In terms of income distribution, although there are ways to reduce the impact of taxes on low income families, the objective of poverty alleviation would be better served by targeting fiscal expenditure. Accordingly, the reform of the Guatemalan tax system could include:

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[12]Effective February 1, 1995, amendments to the Penal Code were introduced to provide for criminal penalties for tax evasion. Accordingly, any procedure deliberately used by individuals and entities to minimize or to avoid payment of taxes is treated as a **criminal offense**, including possible imprisonment.

[13]P. Schome, Tax Policy Handbook, IMF, Fiscal Affairs Department, 1995; G.A. Mackenzie, David W.H. Orsmond, and Philip R. Gerson, Occasional Paper 149, International Monetary Fund, March 1997.

- An increase in the tax rates for the VAT, the income tax and some excises.

- Elimination of all exemptions/deductions not justified either by technical reasons or by international agreements/practice. In this area the authorities should evaluate the impact of the exemptions granted by the Constitution and the benefits of changing the regime.

- A set of measures to strengthen tax administration: improve early detection of delinquent tax payers, increase penalties for noncompliance and establish systematic audit plans with emphasis on the VAT/customs and major or special taxpayers. The strengthening of human and capital resources devoted to tax administration should have high priority.

g. Tax policy measures

56. **Value-added tax:** (i) the increase in the rate by at least 3 percentage points (to 13 percent); (ii) the phase out of all exemptions and zero rate regimes, excluding exports and sales in municipal/communal markets (difficult to control), and exemptions granted by international agreements; (iii) the elimination of tax credit refunds in cash or tax certificates, except for exporters (tax credits should be carried over subsequent periods to be compensated with future VAT tax debits); and (iv) the inclusion of tariffs in the base price for imported goods.

57. **Income tax:** (i) the increase of the maximum income tax rate on individuals and corporations to 30 percent; (ii) the reduction of the minimum personal income taxable to about 2½ times the income per capita (iii) the elimination of the VAT credit (if it is considered necessary for VAT enforcement, the minimum exempted income should be lowered); (iv) the phase out of deductions to the personal income base, or at least the establishment of a limit as a percent of the gross income; (v) the elimination of all exemptions including to maquilas and "zonas francas", and tourism developments; and (vi) the extension of the tax on gross income/assets for several years while the administration of the income tax is improved.

58. **Excises:** (i) the increase of the tax on petroleum derivatives by at least 50 percent (to about US$1.0 per gallon in the case of gasoline); (ii) the modification of the beverages tax from *ad valorem* to a specific tax per liter with an indexation mechanism. This change would simplify the tax and avoid difficulties in establishing the appropriate price base, which has presented problems in the past, particularly subvaluation.

h. Tax administration

The strengthening of the tax administration requires:

- Acceleration of the steps needed to make the SAT fully operational as soon as possible, including by providing appropriate human and capital resources.

- Modification of the tax code to facilitate closing of establishments at the first tax violation, and elimination of the limit of 20 percent for the penalties.

- Strengthening the early detection and control of collection mechanisms, and improvement of the audit systems based on cost effectiveness. Attention should concentrate on the VAT and large taxpayers, including with the creation of the "special taxpayers" unit within the SAT.

III. Trade Regime—Openness, Structure, and the Effects of Trade Liberalization

A. Background and Early Developments

a. Regional import substitution policy

59. Guatemala belongs to the Central American Common Market (CACM)[14] which was created in 1960 to promote growth, industrialization, and nontraditional exports; and to reduce the region's dependence on traditional agricultural crops and vulnerability to commodity price shocks. An important aspect of the CACM's development strategy was a **regional import substitution policy (RISP)** that applied a common external tariff (CET) to imports from third countries, while exempting regionally produced items from tariff and nontariff barriers.[15] The CET's key feature was generally higher protection for manufacturing relative to the other sectors and for consumer goods (particularly manufactures) relative to capital and intermediate goods (Tables 10 and 11). In general, average tariffs on intermediate and capital goods were actually lower and effective protection on consumer goods was higher than nominal protection because the RISP also allowed extensive tariff exemptions for imports of raw material and capital for industrial firms.

b. Effects of the RISP (1960–80)

60. During the RISP's first two decades, Guatemala's economy and manufacturing sector (and the region's) grew rapidly, and its nontraditional exports, consisting mostly of light

[14]Other members are Costa Rica, El Salvador, Honduras, and Nicaragua. After the Central American Protocol was modified in 1994, Panama became an observer in the CACM.

[15]Basic agricultural products were excluded from the agreement, and petrofuels, automobiles, and distilled spirits were allowed different external tariffs in each country. Members maintained independent policies on basic agricultural products. Up until the 1990s, Guatemala required import licenses for basic grains and items such as poultry, milk, eggs, and cottonseeds in order to support their domestic price and production.

manufactured products, tripled from 2.4 percent of GDP in 1963 to 7.7 percent of GDP by 1980 (Table 12). Intraregional trade almost tripled from 3 percent of GDP to 8½ percent, while **extraregional** trade grew from 23 percent of GDP to 29½ percent. The higher trade ratio may suggest that the Guatemalan economy became more open during 1963–80 despite the import substitution policy, but it also camouflaged various weaknesses of the RISP.

61. First, reflecting the RISP's incentive structure, the policy encouraged the growth of an import and capital intensive manufacturing sector (Table 13). The shift of resources into capital intensive manufacturing was inefficient in an economy rich in labor while the import intensive production fostered low domestic value added activities.

62. Second, the RISP provided little incentive for domestic industry to become internationally competitive and imparted an anti-extraregional export bias to the economy. Of the total increase of 5.2 percentage points of GDP in nontraditional exports in 1963–80, 4.2 percentage points went to the protected regional markets (quadrupling the size of such exports); while nontraditionals to non-CACM markets grew by much less (from 1.1 percent of GDP to 2.1 percent of GDP). This trade pattern was largely replicated in other CACM countries. The RISP largely led to **trade diversion** in manufactured consumer goods, replacing cheaper extraregional consumer imports with more expensive regional production; even though there was also some **trade creation** in the intermediate and capital goods needed from non-CACM markets to sustain the regional manufacturing sector[16] (Willmore, 1976).

63. Thirdly, while the RISP improved regional growth and manufacturing activity (Guatemala in particular benefited because it had the largest manufacturing sector), the policy did not reduce the region's dependence on traditional agricultural exports and vulnerability to commodity price shocks. The expansion of manufacturing exports largely stayed within regional borders and in 1980 the region as a whole continued to rely almost exclusively on a few cash crops—mainly coffee and bananas—for its foreign currency earnings. Import substitution did not improve the region's underlying external position. Table 13 shows that the regional reduction in consumer goods imports from non-CACM markets in 1960–80 (4.3 percent of GDP) fell short of the increase in the capital and intermediate imports needed for manufacturing (4.9 percent of GDP).[17]

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[16]The increase in Costa Rica's and El Salvador's nontraditional exports (of which an estimated 75–80 percent were manufactured goods) also went primarily to the protected regional markets (based on various IBRD country memoranda). Guatemala's imports from non-CACM countries grew by 4 percentage points of GDP in 1963–80, reflecting largely increases in capital and intermediate goods. Imported inputs for the manufacturing sector increased their share of total imports by over 60 percent in the first 20 years of the RISP.

[17]The shortfall would be larger with fuel imports included; disaggregated data on fuel between industrial and other uses are not available.

c. Breakdown of the trade regime (1980–85)

64. Adverse shocks occurred in the early 1980s, as the region's coffee and banana exports suffered protracted price declines, and oil prices rose in 1979–81. In addition, civil wars erupted in two CACM members, Nicaragua and El Salvador. Intraregional trade plummeted, compounded by the countries' resort to exchange controls to protect their reserve positions. In 1982, Guatemala imposed quotas on most imports based on whether they were considered "essential". Nontraditional exports fell sharply, and by 1985 total trade had fallen to 19.5 percent of GDP from 38 percent in 1980 (and 24 percent when the CACM began).

65. The contraction of trade in 1980–85 suggests that the increase in Guatemala's trade ratio in the preceding years was to a large extent based on **protection**, making the economy no less vulnerable to external shocks.[18] The exchange controls in this period had so increased protection that UNCTAD found Central America to be the **most protected** region among developing countries.[19] The depth of the economic crisis prompted policy makers to re-evaluate the RISP strategy and its weaknesses.

B. Trade Reform (1985–96)

a. Beginnings of trade reform (1985–89)

66. An important aspect of the CACM is that, following the difficulties of the early 1980s, the CACM became a tool for liberalization. Recognizing that the early opportunities for rapid growth were likely exhausted, CACM policy makers took steps to liberalize their trade regimes—focusing on removing the exchange control barriers, and decreasing anti-extraregional export bias by lowering the common external tariffs, thus shifting relative prices in favor of extraregional exports and reducing effective protection for import substituting activities.

67. Progress was first made among all CACM countries in phasing out foreign exchange controls and moving toward greater exchange flexibility. The incentives provided to maquila exporters, introduced in 1984, were extended in 1989 to apply also to indirect exporters (domestic suppliers of inputs to nontraditional exporters) and nontraditional agricultural exporters. These incentives (known as Decree 29–89) provided full exemption of import duties and VAT on raw materials, intermediate inputs, and machinery and equipment used in the production or assembly of goods for export to non-CACM markets, and income tax

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[18]This supports the idea that the trade ratio is only one measure of openness and merely indicative of outward orientation (L. Pritchett, 1991).

[19]UNCTAD's estimates for 1985 (for tariff and nontariff protection) were: Caribbean 17 percent; Central America 66 percent; South America 51 percent; North Africa 39 percent; other Africa 36 percent; West Asia 5 percent; other Asia 25 percent (Erzan et al., 1989).

exemption on profits related to such activities (for a period of ten years). While these subsidies were second-best solutions compared to tariff elimination, they helped to mitigate the anti-extraregional export bias of the economy.

68. In 1986, the CACM introduced a **revised CET**, which featured reduced rates, elimination of an existing 30 percent import surcharge, adoption of a modern system of tariff classification, and elimination of the regional agreement on tariff exemptions.[20] The average legal tariff rate (unweighted)[21] in Guatemala fell to 25 percent in 1987 from about 30 percent in 1981 while the maximum legal rate fell to 100 percent from 300 percent. In addition, the average tariff on consumer goods was reduced to 36 percent from 45 percent in 1981.

69. While data are weak, there is some evidence that reductions of tariff and nontariff barriers during 1985–88 helped to lower the relative price of manufactured goods in Guatemala vis-à-vis competing goods in world markets, thereby increasing the relative attractiveness of exporting nontraditionals to non-CACM markets. During this period (data are only available through 1988) the price of manufactured goods in Guatemala relative to consumer goods prices in the U.S. fell by 26 percent compared with an increase of 7 percent in 1980–84 (Table 16).[22]

70. In spite of the substantial progress in trade liberalization, some regressive steps were also taken. In 1986, Guatemala imposed substantial export taxes on coffee (27 percent); sugar to the U.S. market (27 percent); cardamom (22 percent); bananas (*ad valorem* equivalent of 16 percent); and nontraditional exports to Central America (4 percent), and in 1987

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[20]The new structure contained three parts: Part I, comprising 90 percent of tariff positions, covered regionally-agreed items; Part II, about 5 percent of tariff positions, covered items on which agreement could not yet be reached, deemed "sensitive" items—mainly textiles, clothing, shoes, and paper products; and Part III, the other 5 percent of positions excluded from the treaty, mainly petroleum products, automobiles, and alcoholic beverages.

[21]An unweighted average tariff is preferable to an average based on customs duties collected since the latter reflect exemptions. An unweighted average is preferable to a trade-weighted average since items with high tariffs would likely have small trade weights (see IMF, 1997 "Trade Liberalization in Fund-Supported Programs", EBS/97/163).

[22]Changes in this relative price of equivalent tradables can be viewed as reflecting broadly the effects of liberalization, rather than exchange rate changes. Suppose Pf=the world price of tradables, and the price of the locally produced equivalent is $Pg=E*Pf*(1+t)$ where E=exchange rate and t=tariff and nontariff barriers. The relative price is $R=[E*Pf*(1+t)/[E*Pf]$ or $R=(1+t)$, thus, independent of the exchange rate, but declining with the tariff rate.

re-introduced an import surcharge (3 percent)—all intended to compensate for the fiscal costs of the tariff reductions. Also, the 1986 reforms introduced a distinction between competing and noncompeting capital and intermediate imports, with competing imports (those also produced in Central America) carrying higher rates (10–30 percent) than noncompeting imports (5–10 percent). These provisions contained a latent threat of increased protection, as CACM producers could petition for the higher protection given to CACM-produced goods.

b. Acceleration of Trade Liberalization Measures (1990–97)

71. In November 1988, the CACM countries agreed to renew efforts to further reduce tariff rates and to allow members to adjust their external tariffs independently. As a result, all CACM countries reduced their tariffs substantially in the 1990s.

72. **Tariffs**: During the 1990s, Guatemala reduced its maximum legal tariff rate from 100 percent in 1987 to 19 percent by 1997; the unweighted average economy-wide tariff from 25 percent to 10 percent; and the dispersion of tariffs from 22 percent to 10 percent.[23] The reforms also succeeded in offsetting partly the RISP bias in favor of manufactured and final consumer goods and reducing the effective rate of protection (ERP) on the latter.[24] Rough calculations by the staff suggest that the ERP on consumer goods fell from 62 percent in 1987

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[23]The average tariff rate was reduced to 20 percent in 1990; 12 percent in 1993; and 10 percent by 1996. The dispersion rate was reduced to 15 percent in 1990, 9 percent in 1993, but increased to 10 percent by 1996. The tariff schedule under the new 1993 CET was disaggregated to 5,780 items (1,898 items before).

[24]By 1996, the average tariff on manufactured goods had been reduced to 10 percent from 26 in 1987; on agriculture to 11 percent from 21 percent. The average tariff on consumer goods had been reduced to 18.5 percent from 36 percent; on intermediate goods to 7.9 percent from 17.6 percent; on capital goods to 3 percent from 19 percent.

to 38 percent in 1996.[25] [26] **Export Taxes**: In 1990, the export taxes imposed in 1986 were abolished, removing a substantial disincentive for exports.

73. **Liberalization of the agricultural sector**: In 1992, import licenses for basic grains were replaced by price bands with variable tariffs of between 5 and 45 percent in order to buffer domestic production from wide swings in international prices. These bands were removed in October 1995, replaced in many cases (yellow corn, sorghum, soybean) by equivalent tariffs. In the 1990s, import licenses for fertilizers, pesticides, and herbicides, and animal fats, and export licenses for cardamom, oilseeds, and livestock products were removed. The remaining products subject to export licenses are coffee, sugar, cacao, eggs, basic grains for extraregional trade, peanuts, sunflower seeds, and tobacco, although these licenses are in general liberally issued.

74. **Exchange system**: The exchange system was moved firmly towards full liberalization in the 1990s. A system based on foreign exchange auctions was maintained in 1990–94, which allowed the exchange rate to fluctuate within an adjustable band. This was replaced in 1994 by a market system based on the interbank foreign exchange market.

75. The exchange liberalization in the late 1980s and early 1990s allowed the quetzal to depreciate in real effective terms, helping to shift relative prices in favor of exports to non-CACM markets. The major beneficiary has been particularly **nontraditional agricultural exports** (such as various fruits, vegetables, cut flowers, and shrimps), which are mostly non-competing imports in the advanced economies. In this regard, nontraditional agriculture also benefited from agricultural liberalization, such as the removal of import licenses on basic grains and fertilizers, which also tended to shift relative prices in favor of nontraditional agriculture and reduced costs as well.

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[25]The estimate of 38 percent for consumer goods appears to be in line with recent calculations made by ECLAC in an ongoing study on effective protection for the Central American countries. While ECLAC estimates the average ERP of 47 groups of activities at 12.9 percent, rates of protection on most consumer goods range between 30 and 40 percent.

[26]Assume P=world price of final goods; I=world price of inputs; t(f) = tariff on final goods; and t(i)=tariffs on inputs. Then ERP is the excess of value added in domestic prices over the value added in world prices, thus,

$$ERP = [P*(1+ t(f)) - I*(1+ t(i))]/[P-I] - 1;$$
$$= [P*t(f) - I*t(i)]/[P-I];$$
$$= [t(f)-a*t(i)]/[1-a] \text{ where } a=0.6=I/P, \text{ inputs' share in final good.}$$

Thus, assuming that capital and intermediate inputs constitute about 60 percent of the value of final goods measured at world prices, and using the decline of unweighted average tariffs in 1987–96 (36 percent to 18.5 percent for consumer goods; roughly 19 percent to 6 percent for inputs) as proxies for the drop in actual rates, the ERP for consumer goods is estimated to have fallen by about 25 percentage points over the period.

76. **Intraregional trade**: Following the problems in the 1980s, intraregional trade largely normalized by the 1990s. Most imports enter duty-free although duties continue to apply to sensitive items—textiles, footwear, clothing, and tires. In 1993, however, in a regressive move, quantitative restrictions were imposed on wheat flour, ethyl alcohol, alcohol, cigarettes, petroleum products, and coffee, even though there was little intraregional trade of these items.

c. Trade structure 1985–96

Recovery of nontraditional exports

77. The general success of the 1985–97 reforms—particularly the reductions in tariffs and ERP for consumer goods—in reducing anti-extraregional export bias has been reflected in the performance of nontraditional exports. After declining in the early 1980s, nontraditional exports grew by 10.3 percent a year (in U.S. dollar terms) on average in 1985–96. While traditional exports grew by only 3.6 percent a year because of weak commodity prices, nontraditional exports increased from 3.5 percent of GDP in 1985 to 8.1 percent in 1996 (Figure 3); and increased its share of total exports from 35 percent to 58 percent.

78. The recovery reflected mainly increased sales to non-CACM markets although exports to CACM markets also advanced. Exports to non-CACM markets almost quadrupled, from 1.2 percent of GDP in 1985 to 4.4 percent in 1996, while their share of total nontraditionals grew from 34 percent to 55 percent. Within the nontraditionals, manufactured exports to non-CACM markets almost quintupled from 0.6 percent of GDP in 1985 to 2.8 percent in 1996, while nontraditional agricultural exports more than tripled from 0.5 percent of GDP to 1.6 percent.

79. In addition to the effect of trade liberalization, nontraditional exports also have benefited from a number of other factors which were permitted by the more open trade regime.[27] The most important such factor has been the **preferential access** to the United States (Guatemala's largest market) granted via the Caribbean Basin Initiative (CBI) in 1985 and extended in 1991 through the enhanced CBI II Agreement. The CBI allows duty-free or preferential tariff access into the U.S. market, with some exceptions such as textiles, garments, footwear, and sugar. The CBI II provides an indefinite extension to CBI status and exemption from the cumulative clause, which exempts exports from CBI countries when the United States determines injury to U.S. producers. These concessions have particularly stimulated the growth of **maquila exports** to the United States, which grew from almost nil in 1986 to 13.8 percent of nontraditional exports by 1996. Guatemalan exports also enjoy preferential access to the EU under their Generalized System of Preferences program.

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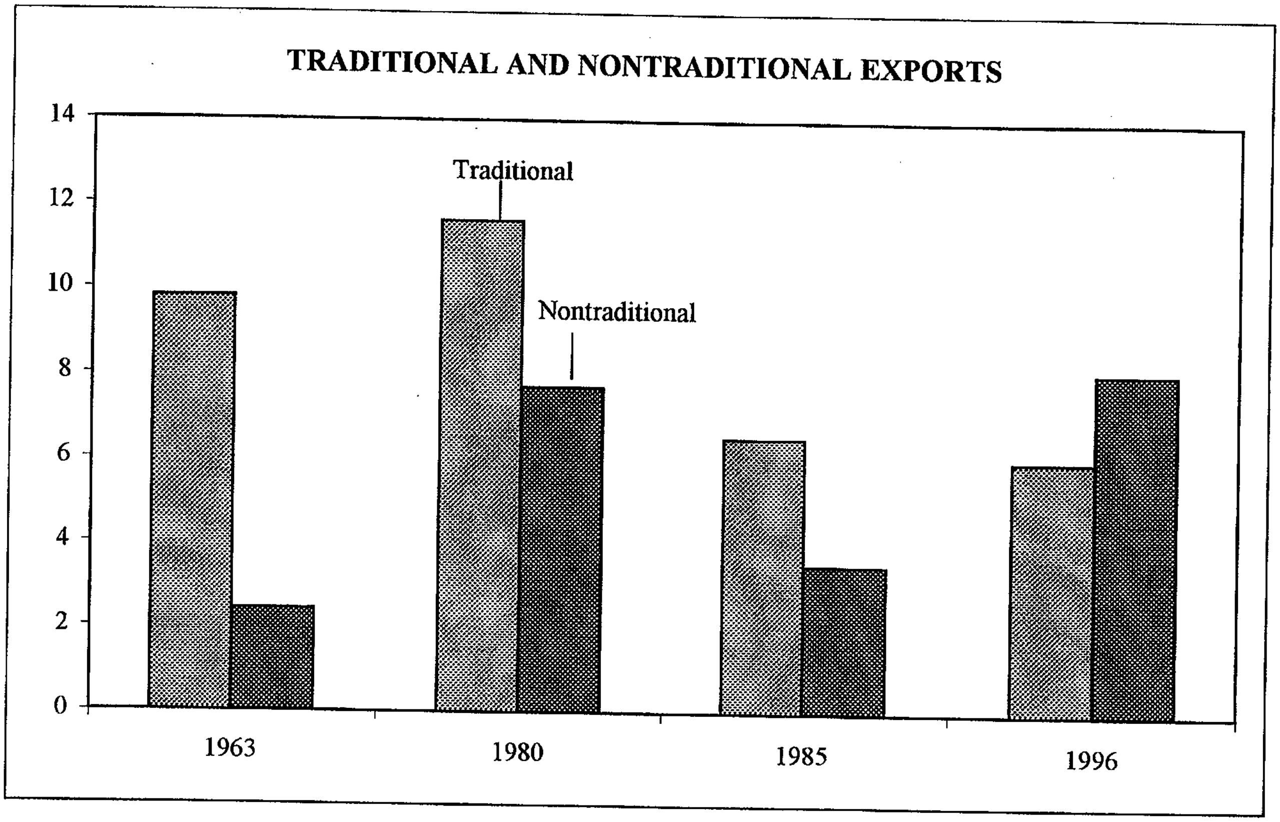
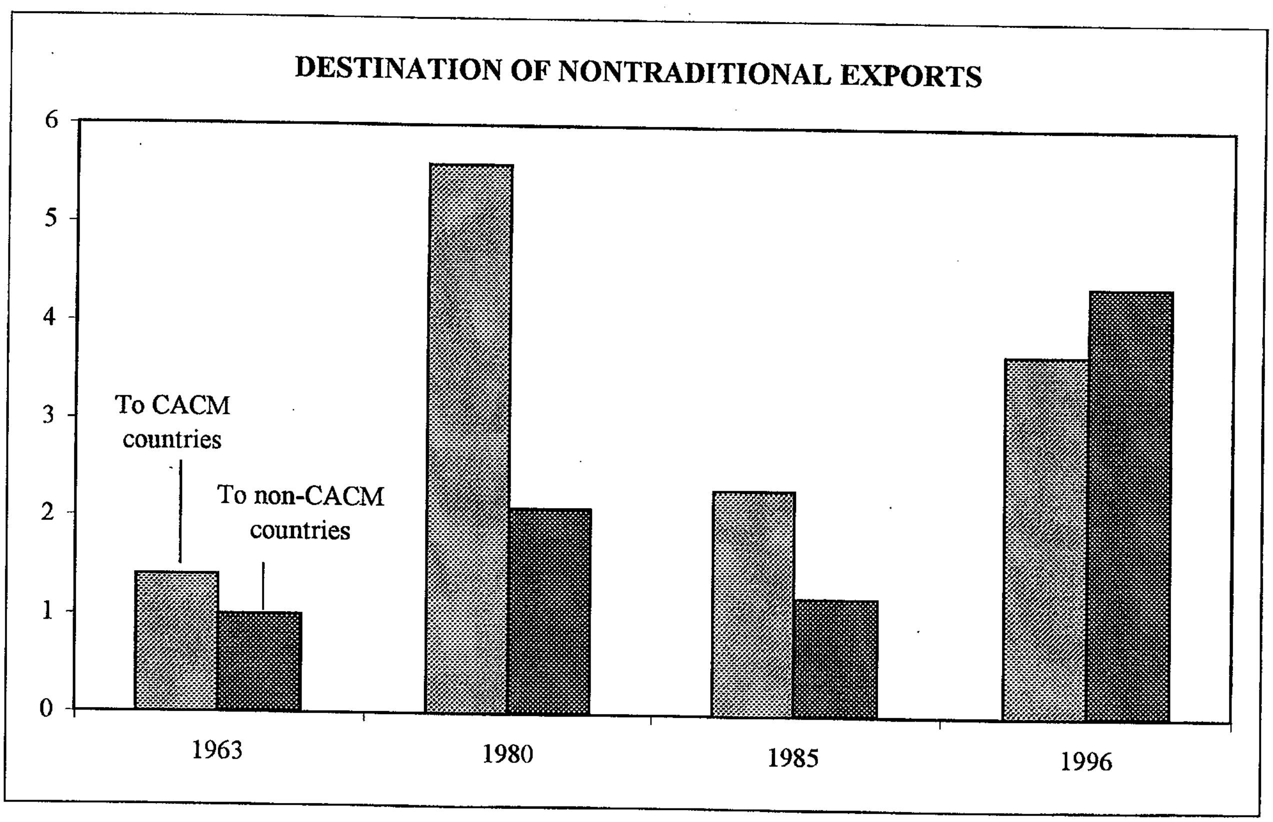
[27]Without liberalization, the disincentives to external trade and resource misallocation may continue to frustrate the positive effects of factors such as preferential access and subsidies. (See IMF, 1992 "Issues and Developments in International Trade Policy).

Figure 3. Guatemala: Export Diversification and Market Access, 1963-1996
(In percent of GDP)





Sources: Bank of Guatemala; and Fund staff estimates.

Within the CACM, nontraditional exports have benefited from **stronger regional economic growth** in the 1990s, as the other member countries have also pursued trade reforms and civil conflict in the region ceased.

Change in the trade structure: comparison with 1980

80. By 1996, Guatemala's trade structure had improved dramatically from that achieved in 1980 (around the peak of success of the former regime). First, the liberalized trade structure in 1996 featured reduced dependence on traditional exports. Secondly, while the ratio of nontraditional exports to GDP was similar in the two years, the proportion of nontraditional exports to non-CACM markets was sharply higher in 1996. Accordingly by 1996, Guatemala had moved closer toward the CACM goals. Not only had it achieved a decline in traditional exports as a proportion of income but the reduced dependence was now also supported by a diversification of nontraditional exports at a global, not merely, regional level.[28]

81. In all, the trade reforms helped restore the trade ratio of Guatemala's economy, which grew from 20 percent of GDP in 1985 to 34 percent in 1996, moving Guatemala again above the average for Latin American countries. While this trade ratio is slightly lower than the 38 percent achieved in 1980, it is likely more reflective of greater openness of the economy.

Measures in 1997

82. In 1997, Guatemala further reduced its maximum tariff rate to 19 percent (from 20 percent in 1996); reduced the rates on raw materials, and intermediate and capital goods produced in CACM countries by 1 percentage point to 9 percent and 14 percent, respectively; and reduced the rates on raw materials, intermediate and capital goods not produced in the region to zero (from 1 to 5 percent in 1996). The average tariff rate is estimated to have declined to about 10.2 percent even though the rate of dispersion remains at 10 percent.

C. Plans for 1998–99 and the Unfinished Agenda

83. For the future, Guatemala and the other CACM countries have committed to reducing their tariffs from the range of 0–19 percent in 1997 to 0–15 percent by 2000 (Table 18). Guatemala has targeted reaching the objective by 1999, aiming to reduce the maximum rate on consumer goods to 17 percent in 1998, and 15 percent in 1999. In addition, the rates on raw materials and intermediate and capital goods produced in Central America will be reduced, respectively, from 9 and 14 percent in 1997 to 5 and 10 percent by 1999. The impact of these measures on the ERP for consumer goods would be another 5 percentage point decline by 1999.[29]

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[28]The results are the same if comparison is done in terms of export shares.

[29]For a larger group of activities, ECLAC estimates an average reduction in ERP by

(continued...)

84. Guatemala has undertaken important liberalization measures in the last decade to reduce the anti-extraregional export bias of its economy and its dependence on traditional exports and vulnerability to commodity price shocks. However, **more remains to be done**. In particular, Guatemala's tariff structure, however, continues to exempt certain products from the maximum tariff rate of 19 percent. Data available for 1996 show that such exemptions are provided to 652 textile and textile-related tariff positions (or 11 percent of the total), which enjoy rates of 30 percent (Table 19). In addition, certain agricultural products enjoy safeguard provisions and are subject to tariff rate quotas, which also allow tariffs well above the maximum rate for imports in excess of quota. For instance, poultry and poultry parts are subject to a quota of 7,000 metric tons, with tariffs of 15 percent within quota and 45 percent in excess of quota. Other examples are apples and pears (12 percent and 25 percent); corn (5 percent and 35 percent); rice (10 percent and 50 percent); and harina de trigo y de morcajo o tranquillon (9 percent and 15 percent). All the quotas are binding except in the case of wheat flour, where high transport costs are reported to have deterred many small importers.[30] [31]

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[29](...continued)
3 percentage points to 10 percent in 1999.

[30]These quotas are adjusted yearly, following discussions between the private sector and government. It should be noted that Guatemala's safeguard provisions are ahead of the schedule established for it under WTO rules.

[31]The other countries of the CACM also allow considerable exemptions from the maximum CET rate of 19 percent. As of 1996, El Salvador has 646 tariff positions outside the maximum rate, with 5 items at 25 percent and 641 items at 30 percent; Costa Rica has 392 positions outside the maximum rate, with rates ranging from 24 to 270 percent but most clustered around 35 percent; Honduras has 5 items outside the maximum rate (3 at 35 percent; 2 at 100 percent); and Nicaragua with 8 items (2 at 250 percent; 6 at 480 percent). Nicaragua, however, has an extra temporary special tariff of 15 percent on most import items.

85. All these exemptions contribute to the sizeable tariff dispersion of 10 percent, which is slightly higher than the average tariff rate, and compares unfavorably with those of many other Latin American countries. Table 17 shows that while Guatemala's average tariff rate is comparatively low among the countries shown, its rate of tariff dispersion is relatively high.[32]

86. In addition, Guatemala's tariff structure continues to provide higher protection to final consumer goods relative to inputs (ERP is estimated at 25 percent for consumer goods in 1996). In this context, the liberalization program for 1998–99 (reducing the consumer goods ERP further by only about 5 percentage points) could be more ambitious.

87. As the other Latin American countries are rapidly liberalizing their economies, Guatemala needs to move to further orient its economy toward world markets. The unfinished agenda for Guatemala must be to rationalize its tariff structure—by implementing **lower and more uniform** tariffs for all or most imports, which would sharply reduce the rate of tariff dispersion and effective protection. A possible first step could be a uniform tariff of about 10 percent, which a recent World Bank study suggests would preserve the level of revenue collection from tariffs. In addition, all the remaining export licenses on agricultural goods could be eliminated. Also, as import tariffs and the anti-export bias of the economy are reduced, an equivalent reduction in export incentives could be implemented for efficiency reasons and to offset the fiscal losses from the tariff reductions.

88. On intraregional trade, the unfinished agenda is to remove the few remaining tariffs and quantitative restrictions so as to implement a full free trade area in the CACM in order to exploit the efficiency gains from free trade. In particular, given the geographic proximity of the CACM countries, full liberalization of intraregional trade barriers would create efficiency gains particularly in the case of certain products that might be nontradable vis-à-vis extraregional markets (because of higher transport costs) but are potentially tradable goods within the regional context.

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[32]Under the schedule of tariff reduction, the nominal tariff dispersion would decline somewhat. ECLAC estimates that Guatemala's ERP dispersion would decrease from 10.6 percent in 1996 to 9.3 percent in 1999.

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Table 7. Exemptions and Deductions on Taxes not Specified in Each Tax Law

Before the November 1997 Law that Eliminates Exemptions and Deductions on Taxes (November 1997)	After the November 1997 Law
General exemptions to all taxes:	General exemptions to all taxes:
COMMERCIAL AND INDUSTRIAL ACTIVITIES Maquilas and Free Zones • Enterprises engaged in maquila activities (temporary admission regime) are exempt from: -import tariffs on inputs, intermediate goods, equipment, and any other good used in the production of export products. -VAT . -income tax for 10 years.	*COMMERCIAL AND INDUSTRIAL ACTIVITIES* Maquilas and Free Zones • Enterprises engaged in maquila activities (temporary admission regime) are exempt from: No change. However, they are subject to the IEMA.
• Commercial and/or industrial activities in free zones: -import tariffs on inputs, intermediate goods, equipment, and any other good used in the production of goods or services. -income tax: 12 years for industrial activities and 5 years for commercial activities. -VAT and stamp tax.	• Commercial and/or industrial activities in free zones: No change. However, they are subject to the IEMA.
• Enterprises located in the free zone "*Santo Tomás de Castilla*": -goods introduced, traded, and/or employed in their activities are exempted from all taxes, including inputs and equipment. -income tax exemption for 12 years.	• Enterprises located in the free zone "*Santo Tomás de Castilla*": No change. However, they are subject to the IEMA.
Other • Guatemalan commercial airlines in all of their operations, including taxes on consumption of combustible.	Other • Eliminated.
• Production of "chicle" and "chiquibul". However, a tax of Q 5 per quintal would apply to these exports. • Vitamin "A" incorporated to sugar, and the equipment used for that purpose.	• Eliminated. • Vitamin "A" incorporated to sugar.
AGRICULTURAL ACTIVITIES • ANACAFE, as a nonprofit organization, except in the case of transactions related to the coffee business. Also purchases of equipment and fertilizers by coffee growers up to 100 quintals. • Imports of inputs and equipment used in the production of milk. Also, producers of milk and dairy products are exempted from income tax for 10 years, and from municipal taxes and VAT. • Farms growing rabbits (up to 5,000 units).	*AGRICULTURAL ACTIVITIES* All eliminated.
TOURISM • Hotel developments and any other tourism related activity in ***any area*** have the following privileges: -import tariff exemption for 5 years. -land tax exemption for 10 years. -exemption of a 100 percent of the income tax for 5 years, and 50 percent for 5 years more, except in the case of developments in *new areas* for which the 100 percent exemption applies to 10 years.	*TOURISM* • Hotel developments and any other tourism related activity in ***new areas*** have the following privileges: -import tariff exemption for 5 years. -land tax exemption for 10 years. -exemption of a 100 percent of the income tax for 10 years.
ENERGY • Projects related to the development of new renewable sources of energy: -import tariffs on inputs and equipment. -VAT. -tax credit against the income tax equal to 100 percent of the investment. The above benefits would be maintained when because of insufficient renewable sources, other sources of energy have to be used.	*ENERGY* • Projects related to the development of new renewable sources of energy: -eliminated. -eliminated. -no change. eliminated.

Table 7. Exemptions and Deductions on Taxes not Specified in Each Tax Law

ARMY • Activities of the "*Banco del Ejército*" (Army Bank). • Operations of the "*Instituto de Previsión Militar*". • All domestic taxes that could be applied to sales by the army store to army staff.	*ARMY* All eliminated.
NONPROFIT ORGANIZATIONS • Imports by "*Cáritas de Guatemala*", "Catholic Relief Services-United States Catholic Conference", and CARE Inc., as well as salaries paid to their foreign staff.	*NONPROFIT ORGANIZATIONS* All eliminated.
Exemptions to import tariffs (not included above)	Exemptions to import tariffs (not included above)
INTERNATIONAL AGREEMENTS • Exemptions granted to diplomatic and consular missions, and those according to international agreements subscribed by Guatemala and ratified by Congress.	*INTERNATIONAL AGREEMENTS* No change.
NONPROFIT ORGANIZATIONS • Imports of goods to be used by the "*Sociedad Protectora del Niño*", "*Asociación de Señoras de la Caridad de San Vicente de Paul*", "*Asociación Centro de Integración Familiar de Guatemala*" for funding purposes.	*NONPROFIT ORGANIZATIONS* • No change.
• Imports of goods and equipment to be used by the firefighters.	• No change.
• Imports by "*Cáritas Arquidiocesana*".	• Imports by "*Cáritas Arquidiocesana*", by "*Cáritas de Guatemala*", "Catholic Relief Services-United States Catholic Conference, and CARE Inc..
• Imports of medicines, medical and surgical equipment, and materials by the National League Against Cancer and by the National Committee for the Blind and the Deaf, as well as imports of inputs and equipment used by that organization in schools and training centers for the rehabilitation of the blind and the deaf.	• No change.
• Imports of goods by NGOs and other social assistance agencies.	• Eliminated.
Exemptions to income tax (not included above)	Exemptions to income tax (not included above)
PROTECTED AREAS • Individuals or corporations in activities related to the development of protected areas: reduction of 50 percent of the income tax.	*PROTECTED AREAS* Eliminated.
Exemptions granted by the Constitution The Constitution of Guatemala establishes the following exemptions: • Real estate properties of religious organizations used for the cult, for education, or for social assistance would be exempt from any tax or contribution. • Private schools or educational institutions would be exempt from all taxes. • Universities are exempt from any taxes or contributions. • Donations made to the universities and cultural or scientific centers can be deducted from the net income base subject to the income tax. • "*Confederación Deportiva Autónoma de Guatemala y Comité Olímpico Guatemalteco*" are exempt from all taxes. • The Social Security Institute is exempt from all taxes or contributions.	Exemptions granted by the Constitution No change.

Table 8. Value-Added Tax

1992 Law	1994 Modifications	1996 Modifications
Rate 7 percent	Rate **7 percent plus 3 percent to be effective after the signing of the Peace Accords, or January 1996, whichever first. The increment of 3 percent would be earmarked for the financing of peace-related projects through the municipalities, regional councils, and peace-related funds.**	Rate 7 percent plus 3 percent additional earmarked for the financing of peace-related projects through the municipalities, regional councils and peace-related funds **(1 percent each).**
Tax base This tax is applied to sales of goods and services, imports, leasing agreements, payments with goods and donations. The tax base is the price of the good or service less customary discounts, plus financial charges. For imports, it is the CIF value of the goods.	Tax base No change.	Tax base No change.
Exemptions	Exemptions	Exemptions
A. The VAT should not be charged for:	A. The VAT should not be charged for:	A. The VAT should not be charged for:
INTERNATIONAL TRADE TRANSACTIONS -imports of goods by: (i) cooperatives to be used in their business operations; (ii) maquila industry; (iii) travelers.	*INTERNATIONAL TRADE TRANSACTIONS* -imports of goods by: (i) cooperatives to be used in their business operations; (ii) maquila industry; (iii) travelers; **(iv) diplomatic and consular missions and their officials, as well as designated international agencies and their officials.**	*INTERNATIONAL TRADE TRANSACTIONS* -No change.
-exports.	-exports.	**-exports of goods and services**
FINANCIAL TRANSACTIONS -services provided by supervised financial institutions and authorized stock exchange.	*FINANCIAL TRANSACTIONS* -No change.	*FINANCIAL TRANSACTIONS* No change.
-issue and transfer of credit instruments.	-issue, transfer or trade of credit instruments, **bonds and stocks.** **-services provided by credit unions.** **-interest on financial instruments issued by nonfinancial enterprises and traded in the stock exchange.**	
-transfer of property related to the creation and dissolution of trust funds, or to associations, corporations, or by wills.	-No change.	
NONPROFIT ORGANIZATIONS -contributions to nonprofit organizations, membership fees of sporting, professional, social, and cultural associations.	*NONPROFIT ORGANIZATIONS* -contributions to nonprofit organizations, membership fees of sporting, professional, social, cultural, **scientific, and educational associations, and political parties.** **-educational, social, and religious services provided by nonprofit institutions.**	*NONPROFIT ORGANIZATIONS* No change.

Table 8. Value-Added Tax

1992 Law	1994 Modifications	1996 Modifications
Exemptions (continued)	Exemptions (continued)	Exemptions (continued)
B. Zero rate regime (the VAT should not be charged/paid)	B. Zero rate regime (the VAT should not be charged/paid)	B. Zero rate regime (the VAT should not be charged/paid)
-private and public schools, universities, the Guatemalan Olympic Committee, the Sporting Federation, and the Guatemalan Social Security Institute (IGSS). -diplomatic and consular missions and their officials, designated international agencies and their officials.	-No change.	-No change in any.
-nonprofit associations, funds, social service, and religious institutions. -municipalities.	-Eliminated. -Eliminated. **-cooperatives in their transactions with their associates.**	
Tax credit	Tax credit	Tax credit
•The VAT to be paid every month is equal to the VAT obligation emerged in the sale of goods and services (tax debit) less the VAT paid on the purchase of goods and services (tax credit).	•No change.	•No change.
•If the sum of tax credits is higher than the sum of tax debits, after two months, *all taxpayers* have the right to request at the end of each calendar quarter: -credit against other tax obligations. -a negotiable tax certificate to be used to pay other taxes. -cash reimbursement.	**•If the sum of tax credits is higher than the sum of tax debits, *all taxpayers* have the right to carry it over the following periods, but would not receive reimbursement, except in the case of *exporters*, or those who sell goods or services to exempt clients, who would receive a quarterly compensation either in cash or in the form of a negotiable tax certificate.**	•If the sum of tax credits is higher than the sum of tax debits, all *taxpayers* have the right to carry it over the following periods, but would not receive reimbursement, except in the case of **exporters**, or those who sell goods or services to exempt clients, who would receive a quarterly compensation either in cash or in the form of a negotiable tax certificate. **Exporters would have the right to credit the tax credit against the income tax, or to participate in a special regime by which they can request a monthly refund in cash, equivalent to 90 percent of the tax credit.**
•Internal Revenue would have 60 days to process and complete the request.	•Internal Revenue would have **30 days** to process and complete the request.	•No change.
•Tax refunds would be financed from a revolving fund established by the Ministry of Finance.	•No change.	•Tax refunds would be financed from a revolving fund established by the Ministry of Finance, **except for tax credits through the special regime.**
•Pending tax credits from the previous law could not be carried over. They would have to be reimbursed with tax certificates with a maximum two-year maturity.	**•Pending tax credits from the previous law could not be carried over, but they could be credited against the income tax.**	•No change.
		Special regime •A special fund would be created at the central bank to attend cash refunds to exporters that register for the special regime. This fund would be financed with earmarked revenues equal to 15 percent of VAT collection. Once a request has been filed, the central bank should proceed with the refund in 10 days.

Table 9. Income Tax

1992 Law	1994 Modifications	1997 Modifications
COVERAGE	COVERAGE	COVERAGE
The income tax affects all income of individuals or enterprises, nationals or not, residents or not, obtained from labor and/or capital in the Guatemalan territory. Special cases included in the base: • Salaries and any other remuneration paid to representatives, advisors, members of the board abroad, crew of commercial vessels/airplanes or any other means of transportation operating abroad but registered in Guatemala. • Payments from property income, technical assistance provided from abroad to residents. • Income from exports. • Insurance policies given to foreign companies. • Income from transportation, communication services between Guatemala and foreign countries, domestic operations of agencies, branches, or agents of foreign companies, production, distribution, leasing of movies, videos, recorded music, cable. • Income obtained from entertainment, lottery, and similar games.	No change.	No change except as presented below: • Income from transportation **(freight and passengers)**, communication services between Guatemala and foreign countries, domestic operations of agencies, branches, or agents of foreign companies, production, distribution, leasing of movies, videos, recorded music, cable. • Income obtained from entertainment, lottery, and similar games.
A. INDIVIDUALS	A. INDIVIDUALS	A. INDIVIDUALS
Tax base: Salaries, bonuses, and any other remuneration earned as employees. Income from entrepreneurial activities would be taxed as corporations on a net basis (see below).	Tax base: No change.	Tax base: No change.
Deductions and credits: *Deductions* (to obtain net income) • Minimum salary of Q 24,000. • Contributions to the Social Security Institute, Army Pension System, pension plans, life, accident, and medical expenses. • *"pensiones alimenticias."*	Deductions and credits: *Deductions* (to obtain net income) • Minimum salary of Q 24,000. • Contributions to the Social Security Institute, Army Pension System, **individual (capitalization)** pension plans, life, accident and medical expenses. • *"pensiones alimenticias."*	Deductions and credits: *Deductions* (to obtain net income) • **Minimum salary of Q 36,000.** • Contributions to **professional associations**, the Social Security Institute, Army Pension System, individual pension plans (capitalization), life, accident, and **hospital insurance**. • *"pensiones alimenticias."* • **Donations to public entities, nonprofit organizations (social assistance, scientific, cultural), universities, political parties, and professional associations.** • **Medical expenses.**
Credits • VAT paid up to 7 percent of net income.	*Credits* No change.	*Credits* • **VAT paid up to a percent of net income equal to the VAT rate.**
Tax rates	Tax rates	Tax rates
Net income — Marginal rate 1.Q 0 – Q 20,000 — 15.0 percent 2. Q 20,000 < net inc. <65,000 — 20.0 percent 3. Q >65,000 — 25.0 percent	Net income — Marginal rate 1.Q 0 – **Q 65,000** — 15.0 percent 2. **Q 65,000 < net inc. <180,000** — 20.0 percent 3. **Q >180,000** — **30.0 percent**	Net income — Marginal rate 1.Q 0 – Q 65,000 — 15.0 percent 2. Q 65,000 < net inc. <180,000 — 20.0 percent 3. Q >180,000 — **25.0** percent

Table 9. Income Tax

1992 Law	1994 Modifications	1997 Modifications
B. ENTERPRISES	B. ENTERPRISES	B. ENTERPRISES
Tax base Gross income minus expenses and costs directly and indirectly related to the production of goods or services: • contributions to social security and any other labor-related cost. • donations to nonprofit organizations. • expenses in the construction, maintenance, and operation of schools, hospital, health, cultural, educational and recreational services, housing, all for the benefit of the workers. • organizational expenditures to be amortized in 10 years. • reinvestment of profits up to 20 percent in plant, machinery and equipment, or up to 5 percent in projects on education, cultural, sports, housing for the benefit of workers and their families.	Tax base No change.	Tax base No change except as presented below: **• organizational expenditures to be amortized in 5 years.** **• reinvestment of profits up to 15 percent, and an additional 5 percent in training of the enterprise's workers. Alternatively, up to 5 percent in projects on education, cultural, sports, housing for the benefit of workers and their families.**
Tax rate Flat rate of 25 percent.	Tax rate **Flat rate of 30 percent.**	Tax rate **Flat rate of 25 percent (gradual reduction to 27.5 percent in June 1998 and to 25 percent in June 1999).**
ANTICIPATED PAYMENTS	ANTICIPATED PAYMENTS	ANTICIPATED PAYMENTS
Enterprises should make quarterly payments equal to 1.5 percent of gross income less tax withholdings (excluding capital gains and exempt profits).	**Enterprises must make quarterly payments according to three options given to determine the quarterly income tax base.**	No change.
Special Cases -enterprises with annual gross sales ≤ Q 600,000 should anticipate 1 percent of gross income. -retail sales of petroleum derivatives should anticipate 1.5 percent of gross profit.	Special Cases **-enterprises with annual gross sales ≤ Q 1,000,000 may anticipate 8 percent of the quarterly gross sales as final payment.** **-retail sales of petroleum derivatives may anticipate 1.5 percent of gross profits.** **-exporters may anticipate 1.5 percent of the equivalent in quetzales of the FOB value of exports during the quarter.**	
SPECIAL CASES	SPECIAL CASES	SPECIAL CASES
NONRESIDENTS	*NONRESIDENTS*	*NONRESIDENTS*
The domestic agents, representatives, or individuals/enterprises that have business with nonresidents should withhold and pay the corresponding tax, according to the following rates (this tax would be final):	The domestic agents, representatives, or individuals/enterprises that have business with nonresidents should withhold and pay the corresponding tax, according to the following rates (this tax would be final):	The domestic agents, representatives, or individuals/enterprises that have business with nonresidents should withhold and pay the corresponding tax, according to the following rates (this tax would be final):
1. 12.5 percent on dividends, profit sharing, profits and any other benefit obtained from resident enterprises.	1. 12.5 percent on dividends, profit sharing, profits and any other benefit obtained from resident enterprises.	1. **10 percent on dividends, profit sharing, profits and any other benefit obtained from resident enterprises, salaries, commissions, bonuses, and any other taxable retribution.**

Table 9. Income Tax

1992 Law	1994 Modifications	1997 Modifications
NONRESIDENTS (continued)	*NONRESIDENTS* (continued)	*NONRESIDENTS* (continued)
2. 12.5 percent on salaries, interest payments (excluding those to financial institutions), commissions, bonuses, and any other taxable retribution.	**2. 20 percent on salaries, interest payments (excluding those to financial institutions), commissions, bonuses, and any other taxable retribution.**	**2. 25 percent on payments for royalties, patents, trade marks, and scientific, economic, technical and financial advise (to be lowered gradually from 30 percent—see above).**
3. 25 percent payments for royalties, patents, trade marks, and scientific, economic, technical and financial advise.	**3. 30 percent payments for royalties, patents, trade marks, and scientific, economic, technical and financial advise.**	**3. 4 percent on payments for tourist services provided from abroad to domestic agents.**
4. 3 percent of gross income received by transportation companies for freight charges and sales of airline tickets, related to travels between Guatemala and the rest of the world.		**4. 4 percent of gross income received by transportation companies for freight charges and sales of airline tickets, related to travels between Guatemala and the rest of the world.**
5. 25 percent of any payment not included above.	**4. 30 percent of any payment not included above.**	**5. 25 percent of any payment not included above** (to be lowered gradually from 30 percent—see above).
CAPITAL GAINS Affected by an income tax of 15 percent.	*CAPITAL GAINS* No change.	*CAPITAL GAINS* Affected by an income tax of **10 percent.**
PRESUMPTIVE INCOME 1. Professionals. If the taxpayer has not filed income tax form, an annual net income of Q 48,000 is assumed. This taxable income is reduced by 50 percent for individuals that have obtained their degree less than 5 years ago. 2. 10 percent of insurance premiums, and similar transactions is considered taxable income.	*PRESUMPTIVE INCOME* No change.	*PRESUMPTIVE INCOME* 1. Professionals. If the taxpayer has not filed income tax form, an **annual net income of Q 72,000** is assumed. This taxable income is reduced by 50 percent for individuals that have obtained their degree less than 3 years ago. 2. No change.
3. Movies and similar activities, and news services. The taxable income would be equal to 60 percent of received payments. The individual or enterprise that makes the payment has to deduct 25 percent of the taxable income at the time of payment.	No change.	No change.
TAX WITHHOLDINGS (selected cases)	TAX WITHHOLDINGS (selected cases)	*TAX WITHHOLDINGS* (selected cases)
1. Individuals or enterprises acting under the "Código de Comercio" should withhold the income tax as a definite payment as follows:	**The articles that included the tax withholding provisions was suspended in early 1995 and declared unconstitutional by the Constitutional Court in 1995–96.**	**The concept of tax withholdings was changed to a definite payment of the income tax in this revision to avoid suspension by the Constitutional Court.**
• 10 percent on interest paid on financial instruments not issued by supervised financial institutions (including paper issued by the government or any public agency).		**1. Winners of lottery, raffles, bingos or any similar event should pay a tax equal to 10 percent of the amount of the prize. The agents in charge of the event should withhold this amount at the time of payment.**

Table 9. Income Tax

1992 Law	1994 Modifications	1997 Modifications
TAX WITHHOLDINGS - selected cases (continued)	TAX WITHHOLDINGS - selected cases (continued)	*TAX WITHHOLDINGS* - selected cases (continued)
• 10 percent on lottery, raffles, bingos, or any similar event. 2. Exporters of merchandise should pay in advance 1½ percent on the value of exports (this amount would be credited against the final income tax liability).		**2. A voluntary withholding regime is established for resident taxpayers that have not chosen the quarterly payments system. Accordingly, the individuals or enterprises acting under the "Código de Comercio" should withhold 4 percent for payments related to:** **• technical, professional, or scientific activities.** **• services provided by any individual or enterprise, except those institutions supervised by the Superintendency of Banks.** **• Transportation services.** **• Leasing.** **• Payments to sportsmen, professional artists.**
GENERAL EXEMPTIONS	GENERAL EXEMPTIONS No change except for those presented below:	GENERAL EXEMPTIONS No change except for those presented below:
• Income received by individuals/enterprises exempt by other laws.		
• Income received by the State and its institutions, enterprises (except in the case of shared capital) or decentralized agencies.		
• Income received by religious institutions, universities, and other nonprofit organizations (charity, social assistance, cultural, scientific education, art, literary, sports, political, professional associations, unions), indigenous communities and agricultural enterprises (parcelarios), cooperatives in transactions with their members or with other cooperatives.		
• Dividends and profit sharing as long as the recipients include them in their income tax base.		
• Interest paid by the public sector to creditors.		
• Compensations or pensions received because of death or disability, retirement, including those received by Guatemalan residents from abroad, income and benefits paid by social security institutions, and annual bonuses (up to 100 percent of salary).		• Compensations or pensions received because of death or disability, retirement, including those received by Guatemalan residents from abroad, income and benefits paid by social security institutions, annual bonuses (up to 100 percent of salary), and the new special bonus (granted in May 1994).
• Donations and estates.		
• Income from trust funds with the FHA.	**• Eliminated.**	
• Remuneration, salaries paid to diplomats, consular staff, and official representatives of the Guatemala government abroad (including travel expenses), and of foreign governments in Guatemala (excluding Guatemalan nationals).		
• Technical assistance expenditures provided to official institutions by foreign governments or institutions, or by residents financed with foreign grants.	**• Remuneration of technical assistance provided to official institutions by foreign governments or institutions, or by residents financed with foreign grants.**	

Table 10. Guatemala: Average Legal Import Tariffs, 1981–96 1/

	1981	1987	1990	1993	Prel. 1996
Whole economy					
Number of items	1,200	1,859	1,881	5,780	5,780
Maximum	300	100	37	20	20
Minimum	1	0	0	5	1
Mean	...	25.2	19.8	11.7	10.2
Standard deviations	...	21.7	14.9	8.7	9.9
Agriculture	...	21.3	15.9	12.5	11.4
Manufacturing	36.7	25.7	20.2	11.8	10.3
Mining	...	10.9	7.6	7.2	4.9
Consumer goods	45.1	36.2	26.4	18.7	18.5
Intermediate goods	27.3	17.6	15.2	9.7	7.9
Capital goods	...	19.4	17.6	6.3	3.2

Sources: World Bank; ECLAC; Banco de Guatemala; and Fund staff estimates.

1/ Unweighted.

Table 11. Guatemala: Frequency Distribution of Nominal Tariffs for the Manufacturing Sector, 1981

(In percent of total)

Rates	All Products	Nondurable Consumer Goods	Intermediate Products
Less than 1	1.4	2.4	0.0
1 to 25	43.6	30.3	59.9
26 to 50	25.6	26.2	29.6
51 to 75	21.6	28.0	9.3
76 to 100	5.1	7.9	0.0
Greater than 100	2.8	4.8	1.2
Mean 1/	36.7	45.1	27.3
Standard deviation	25.0	29.1	18.2

Source: World Bank.

1/ Unweighted.

Table 12. Guatemala: Trade Structure, 1963–96

	1963	1980	1985	1996
	(In millions of U.S. dollars)			
Total trade	325.1	2,992.4	2,188.9	5,359.5
Exports	154.1	1,519.8	1,112.2	2,213.3
Traditional exports	123.8	912.2	724.7	937.7
Nontraditional exports	30.3	607.6	387.5	1,275.6
Extraregional (non-CACM)	13.0	166.8	130.5	697.6
Manufactured exports	...	70.4	67.4	436.4
Agricultural exports	...	55.8	51.9	256.4
Other	...	40.6	11.2	4.8
Intraregional (CACM)	17.3	440.7	257.0	578.0
Manufactured exports	...	70.4	67.4	436.4
Agricultural exports	...	55.8	51.9	256.4
Other	...	40.6	11.2	4.8
Imports	171.0	1,472.6	1,076.7	3,146.2
Extraregional (non-CACM)	151.3	1,255.2	983.9	2,781.2
Intraregional (CACM)	19.7	217.4	92.8	365.0
	(In percent of GDP)			
Total trade	25.7	38.0	19.6	34.1
Exports	12.2	19.3	9.9	14.1
Traditional exports	9.8	11.6	6.5	6.0
Nontraditional exports	2.4	7.7	3.5	8.1
Extraregional (non-CACM)	1.0	2.1	1.2	4.4
Manufactured exports	...	0.9	0.6	2.8
Agricultural exports	...	0.7	0.5	1.6
Other	...	0.5	0.1	0.0
Intraregional (CACM)	1.4	5.6	2.3	3.7
Manufactured exports	...	4.8	2.0	3.3
Agricultural exports	...	0.5	0.1	0.2
Other	...	0.4	0.1	0.2
Imports	13.5	18.7	9.6	20.0
Extraregional (non-CACM)	12.0	15.9	8.8	17.7
Intraregional (CACM)	1.6	2.8	0.8	2.3
Memorandum items:				
All CACM countries				
Total trade	37.4	51.6	30.9	47.8
Traditional exports	13.2	14.2	9.6	9.3
Nontraditional exports	4.9	9.2	3.9	8.9
Extraregional	2.7	3.6	1.9	5.3
Intraregional	2.2	5.6	1.9	3.7
Imports	19.4	28.2	17.5	29.6

Sources: Various RED's; International Finance Statistics; and Fund staff estimates.

Table 13. Guatemala: Imports for Manufacturing as a Proportion of Total

	1960	1980	1985	1995
	(In millions of U.S. dollars)			
Total imports	138.6	1,598.2	1,175.0	3,292.5
Of which				
Capital goods (industry)	8.3	174.6	106.8	477.2
Intermediate goods (industry)	27.0	482.1	397.3	1,131.5
Fuel and lubricants	13.9	339.5	267.7	286.6
Consumer goods	51.7	282.9	224.9	925.5
	(In percent of total imports)			
Total imports	100.0	100.0	100.0	100.0
Of which				
Capital goods (industry)	6.0	10.9	9.1	14.5
Intermediate goods (industry)	19.5	30.2	33.8	34.4
Fuel and lubricants	10.0	21.2	22.8	8.7
Consumer goods	37.3	17.7	19.1	28.1
Capital and intermediate goods (industry)	25.5	41.1	42.9	48.9
Capital and intermediate goods (industry) Plus fuel and lubricants	35.5	62.3	65.7	57.6
	(In percent of GDP)			
Memorandum items:				
CACM imports 1/				
Capital and intermediate goods (industry)	6.0	10.9	...	...
Change between 1960 and 1980		4.9	...	...
Capital and intermediate goods (industry) Plus fuel and lubricants	7.4	16.0	...	...
Changes between 1960 and 1980		8.5	...	...
Consumer goods	6.9	7.0	...	...
Consumer goods from CACM	1.2	5.6	...	...
Consumer goods from non-CACM	5.7	1.5	...	...
Change between 1960 and 1980		-4.3	...	...

Sources: Various RED's; World Bank; and Fund staff estimates.

1/ Because of the lack of detailed data, it is assumed that all capital and intermediate imports are from non-CACM markets and all intra-CACM imports consist of consumer goods. This assumption should not materially affect the conclusions regarding implications for hard currency savings between 1960 and 1980.

Table 14. Guatemala: Structure of Exports, 1963–96

	1963	1980	1985	1996
	(In percent of total exports)			
Total exports	100.0	100.0	100.0	100.0
Traditional exports	80.3	60.0	65.2	42.4
Nontradtional exports	19.7	40.0	34.8	57.6
Extraregional exports	8.4	11.0	11.7	31.5
Manufactured goods	...	4.6	6.1	19.7
Agricultural goods	...	3.7	4.7	11.6
Other	...	2.7	1.0	0.2
Intraregional markets	11.2	29.0	23.1	26.1
Manufactured goods	...	24.8	20.2	23.2
Agricultural goods	...	2.3	1.5	1.3
Other	...	1.9	1.4	1.6
	(In percent of nontraditional exports)			
Nontradtional exports	100.0	100.0	100.0	100.0
Extraregional exports	42.9	27.5	33.7	54.7
Manufactured goods	...	11.6	17.4	34.2
Agricultural goods	...	9.2	13.4	20.1
Other	...	6.7	2.9	0.4
Intraregional markets	57.1	72.5	66.3	45.3
Manufactured goods	...	61.9	58.0	40.2
Agricultural goods	...	5.9	4.2	2.3
Other	...	4.8	4.1	2.8
	(In percent of total exports)			
Memorandum items:				
All CACM countries				
Traditional exports	73.1	60.6	71.4	51.0
Nontraditional exports	26.9	39.4	28.6	49.0
Extraregional markets	15.0	15.5	14.2	28.9
Intraregional markets	11.9	23.9	14.4	20.1

Sources: Various RED's; International Financial Statistics; and Fund staff estimates.

Table 15. Guatemala: Openess--Trade/GDP in Various Latin American and Asian Countries, 1980–96

	1963	1980	1985	1996 1/
	(In percent)			
Guatemala	24.1	38.0	19.1	34.1
Chile	21.7	36.9	42.2	44.3
Bolivia	35.4	30.2	16.7	36.0
Uruguay	20.8	26.9	29.4	29.4
Colombia	20.2	24.8	21.0	28.8
Mexico	13.9	18.5	19.7	53.0
Brazil	11.1	18.0	17.4	14.7
Peru	36.3	16.8	27.8	22.6
Argentina	16.7	11.3	18.1	15.4
Average	**22.2**	**24.6**	**23.5**	**30.9**
Singapore	261.1	191.2	270.7	277.8
Malaysia	83.9	96.2	86.2	158.9
Thailand	30.9	45.7	39.7	72.3
Philippines	27.2	41.7	31.7	59.1
Indonesia	...	43.4	35.8	42.4
Memorandum item:				
CACM	37.4	51.6	30.9	47.8

Source: International Financial Statistics; and Fund staff estimates.

1/ Data for Mexico, Brazil, and Colombia are available only through 1995.

Table 16. Guatemala: Price of Locally Manufactured Goods Vis-à-Vis
Price of Manufactured U.S. Consumer Goods:
Broad Effects of Tariff Reduction 1/

	1980	1981	1982	1983	1984	1985	1986	1987	1988
Value added in manufacturing									
(Millions of Quetzales) 1/	787.9	901.5	785.3	869.3	902.2	1,205.6	1,325.1	1,590.4	1,748.5
Real value added in manufacturing									
(Millions of 1958 Quetzales)	517.0	501.0	465.0	466.0	468.0	465.0	468.0	477.0	488.0
Unit value index	100.0	118.1	110.8	122.4	126.5	170.1	185.8	218.8	235.1
Percentage change		18.1	-6.1	10.5	3.3	34.5	9.2	17.8	7.5
Exchange rate index (Q/US$)									
(Increase=appreciation)	100.0	100.0	100.0	100.0	98.2	62.3	47.8	44.9	40.5
Percentage change		0.0	0.0	0.0	-1.8	-36.6	-23.3	-6.0	-9.9
Index of manufactured consumer goods									
Prices in U.S	100.0	108.9	112.8	114.3	116.5	117.2	114.4	116.8	119.9
Percentage change	52.1	8.9	3.5	1.3	2.0	0.6	-2.4	2.1	2.6
Relative price of manufactured									
Consumer goods	100.0	108.4	98.2	107.1	106.6	90.4	77.6	84.1	79.3
(Increase=higher local prices relative to U.S. prices)									
Percentage change		8.4	-9.4	9.0	-0.4	-15.3	-14.2	8.4	-5.6

Sources: Information Notice System; various World Bank documents: and Fund staff estimates.

1/ Data on nominal value added in manufacturing come from World Bank documents and available only through 1988.

Table 17. Guatemala: Average Tariffs and Dispersion of Latin American Countries in 1995–96 1/

	Average	Dispersion
	(In percent)	
Guatemala	10.2	10.0
Chile	11.0	0.7
Bolivia	9.7	1.2
Uruguay	9.6	7.6
Colombia	11.4	6.5
Mexico	14.2	12.5
Brazil	12.7	9.8
Peru	16.3	3.4
Argentina	13.9	7.4

Source: ECLAC; IDB; and Fund staff estimates.

1/ Unweighted; Data for 1996 for Guatemala; for 1995 for the other countries.

Table 18. Guatemala: CACM Countries Projected Tariff Reductions for Parts I and II Items, 1997–99 1/

	1997	1998	1999	2000
GUATEMALA				
Final consumer goods (maximum rate)	19.0	17.0	15.0	15.0
Items not produced in CACM				
Raw materials and intermediate goods	0.0	0.0	0.0	0.0
Capital goods	1.0	0.0	0.0	0.0
Items produced in CACM				
Raw materials	9.0	7.0	5.0	5.0
Intermediate and capital goods	14.0	12.0	10.0	10.0
EL SALVADOR				
Final consumer goods (maximum rate)	19.0	17.0	15.0	15.0
Items not produced in CACM				
Raw materials and intermediate goods	0.0	0.0	0.0	0.0
Capital goods	0.0	0.0	0.0	0.0
Items produced in CACM				
Raw materials	9.0	7.0	5.0	5.0
Intermediate and capital goods	14.0	12.0	10.0	10.0
COSTA RICA				
Final consumer goods (maximum rate)	20.0	18.0	16.0	15.0
Items not produced in CACM				
Raw materials and intermediate goods	5.0	0.0	0.0	0.0
Capital goods	5.0	1.0	0.0	0.0
Items produced in CACM				
Raw materials	10.0	8.0	6.0	5.0
Intermediate and capital goods	15.0	13.0	11.0	10.0
HONDURAS				
Final consumer goods (maximum rate)	19.0	17.0	15.0	15.0
Items not produced in CACM				
Raw materials and intermediate goods	1.0	0.0	0.0	0.0
Capital goods	0.0	0.0	0.0	0.0
Items produced in CACM				
Raw materials	9.0	7.0	5.0	5.0
Intermediate and capital goods	14.0	12.0	10.0	10.0
NICARAGUA 2/				
Final consumer goods (maximum rate)	15.0	15.0	10.0	10.0
Items not produced in CACM				
Raw materials	0.0	0.0	0.0	0.0
Intermediate goods	5.0	5.0	5.0	5.0
Capital goods	5.0	5.0	5.0	5.0
Items produced in CACM				
Raw materials	10.0	10.0	5.0	5.0
Intermediate goods	15.0	15.0	10.0	5.0
Capital goods	10.0	5.0	5.0	5.0

Sources: SIECA; Banco de Guatemala; and Fund staff estimates.

1/ These projections are preliminary.

2/ Nicaragua has an extra temporary protection tariff varying from 5 to 30 percent, not include in rates shown above.

Table 19. Guatemala: Items Exempt From the 1 to 19 Percent Tariff Range 1/

I. Safeguard provisions (tariff rate quotas)

Product	1996	1997	1996	1997
	Quotas (metric tons)		Tariffs In/Out Quotas(%)	
Poultry and edible poultry parts (Fresh, refrigerated, frozen) (Chicken, turkey, geeze, ducks)	5650	7000	(15, 45)	(15, 45)
Apples and pears	5000	5000	(12, 25)	(12, 25)
Corn	306,200	336,820	(15, 55)	(5, 35)
Rice	25,941	35,350		
Husked			(20, 50)	(10, 50)
Unhusked			(30, 50)	(25, 50)
Harina de Trigo y de Morcajo o Tranquillon	12,698	15,674	(8.28, 15)	(8.28, 15)

II. Other items (as of 1996)	Tariff (%)	Other items (as of 1996)	Tariff (%)
Silk (3 out of 10 positions)	30	Tejidos impregnados, recubiertos, revestidos o estratificados (9 out of 31 positions)	30
Wool, fur, threads, horsehair fabric (Lana y Pelo fino u ordinario; Hilados y tejodos de crin) (14 out of 35 positions)	30	Sweaters, woven textiles (Tejodos de punto) (19 out of 26 positions)	30
Cotton (86 out of 174 positions)	30	Knitted garments (Prendas y complementos de vestir, de punto) (116 out of 119 positions)	30
Artificial or Synthetic Threads (Filamentos sinteticos o artificiales) (40 out of 83 positions)	30		
Syhtetic Fabric (Fibras Sinteticas o Artificiales Discontinuas) (74 out of 127 positions)	30	Cut cloth, clothing (unknitted) (Prendas y complementos de vestir, excepto los de punto) (119 out of 119 positions)	30
Non-woven fabric and basic cloth (Guata, Fieltro, Telas sin Teja; Hilados Especiales,Cordeles) (17 out of 37 positions)	30	Sewn cloth (Los demas articulos textiles confeccionados; conjunto/surtido) (56 out of 60 positions)	30
Carpets, floor covers (Alfombras y Demas Revestimientos para el suelo, de materias textiles) (22 out of 22 positions)	30	Footwear (Calzado, polainas, botines y articulos analogos y sus partes) (32 out of 34 positions)	30
Special textiles, fabric, cloth (Tejidos especiales, Superficies textiles con pelo insertado) (45 out of 51 positions)	30	Portland cement from Mexico	89.54

Source: Bank of Guatemala; and ECLAC.

1/ While some of the items are different, data from ECLAC indicate that El Salvador has 646 items outside the maximum rate (5 items at 25 percent; 641 at 30 percent); Costa Rica has 392 items outside, with rates ranging from 24 to 270 percent but many clustered around 35 percent; Honduras has 5 items outside (3 at 35 percent; 2 at 100 percent); and Nicaragua has 8 items (2 at 250 percent; 6 at 480 percent). Nicaragua, however, has an extra temporary tariff of 15 percent on most import items.