

PD-ABI-963
89143

USAID EVALUATION SUMMARY PART I

(BEFORE FILLING OUT THIS FORM, READ THE ATTACHED INSTRUCTIONS)

A. REPORTING USAID UNIT: USAID/Guatemala-Central American Programs/TRI	B. WAS EVALUATION SCHEDULED IN CURRENT FY ANNUAL EVALUATION PLAN? yes <input type="checkbox"/> slipped <input type="checkbox"/> ad hoc <input type="checkbox"/> Interim <input checked="" type="checkbox"/> final <input type="checkbox"/> ex post <input type="checkbox"/> ex post <input type="checkbox"/>	C. EVALUATION TIMING Interim <input checked="" type="checkbox"/> final <input type="checkbox"/> ex post <input type="checkbox"/> ex post <input type="checkbox"/>			
Eval. Plan Submission Date: FY <u>92</u> Q <u>III</u>					
D. ACTIVITY OF ACTIVITIES EVALUATED (List the following information for project(s) or program(s) evaluated; If not applicable, list title and date of the evaluation report)					
Project No.	Project/Program Title (or title & date of evaluation report)	First PROAG or equivalent (FY)	Most recent PACD (mo/yr)	Planned LOP Cost (000)	Amount Obligated to Date (000)
520-0371	Fiscal Administration Project (FAP)	07/17/89	03/31/94	\$12,400	\$12,400

E. ACTION DECISIONS APPROVED BY MISSION OR USAID/W OFFICE DIRECTOR <p style="text-align: center;">Action(s) Required</p> <ul style="list-style-type: none"> - The MOF must prepare an implementation program for Technical Assistance. This program should be shared with the international organizations that want to give technical assistance to the Ministry of Finance (MOF). - Fully develop the Fiscal Analysis Unit (FAU) as a source of sound fiscal advise to the Ministry. The MOF with United Nations Development Program (UNDP) funds is hiring a 18-month technical assistance to strengthen this unit. - Strengthen the auditing function of the MOF. The MOF with UNDP funds is contracting a 18-months technical assistance to provide the required extra support. - The tax code makes the work of auditors and collections much more difficult than they need to be. The tax code should be modified to make procedures straightforward. 	Name of officer responsible for Action MOF MOF MOF MOF	Date Action to be Completed Open July 1995 July 1995 Open
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(Attach extra sheet if necessary)		

F. DATE OF MISSION OR USAID/W OFFICE REVIEW OF EVALUATION: mo <u>11</u> day <u>02</u> yr <u>93</u>				
G. APPROVALS OF EVALUATION SUMMARY AND ACTION DECISIONS:				
	Project/Program Officer	Representative of Borrower/Grantee	Evaluation Officer	Mission or USAID/W Office Director
Signature				
Typed Name	Ana Yilma Podesangre	Margaret Kromhout	Hilda Arellano, Acting	Hilda Arellano, Acting
	Date: <u>04/13/94</u>	Date: _____	Date: <u>6/13/94</u>	Date: <u>6/14/94</u>

H. EVALUATION ABSTRACT (do not exceed the space provided)

The FAP was designed to assist the Government of Guatemala (GOG) in a comprehensive modernization of its fiscal administration systems. The project has four specific objectives: 1. improvement in the allocation of resources; 2. greater fairness in the distribution of tax burdens and expenditure benefits; 3. modernization of resources to cover the cost of public services; and 4. improved government ability to plan and monitor its fiscal decisions. This close-out evaluation was conducted by IMCC in October and November, 1993 and involved interviews with personnel from USAID, Pat Marwick, Georgia State University, and the MOF, in Guatemala, Washington and Atlanta.

The FAP team has fulfilled almost all components included in the terms of reference. Omissions have been few (eg. limited activities in budgeting) and several important activities have been added that were not specified in the terms of reference. The team played a key role in the implementation of the tax modernization program, the centerpiece of which is the new tax laws approved by Congress in June, 1992. The team worked on many day-to-day implementation tasks in the Ministry, responded to the direct needs of the Minister and Vice Minister, and took the lead in establishing regulations to fit the new tax laws. Other major accomplishments of the FAP included establishment of the Dirección de Análisis Fiscal (FAU) and installation of a modern computerized information system.

The FAP helped the institutionalization within MOF, nevertheless it remains fragile and partial. Some actions must be strengthened by a careful administration, enforcement of laws and goodwill of the MOF highest authorities.

The most important remaining problems are:

- a. The need of the design of a new Tax Code to help support effective tax administration.
- b. The need of additional support on Tax Audits (training, systematization and laws).
- c. The need of a permanent support to the FAU to strengthen its role as assessment unit on fiscal matters.
- d. To improve the poor performance of Tax Revenues by reinforcing the tax audits, supporting the FAU and developing new controls on the expenditure side.

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I. EVALUATION COSTS

1. Evaluation Team Name	Affiliation	Contract Number <u>OR</u> TDY Person Days	Contract Costs <u>OR</u> TDY Cost (US\$)	Source of Funds
Ricardo Silva Oscar Bueso M. Roberto Noriega	IMCC	520-0371-C00-3278-00	\$90,500	LES-2-92-25520-KG13
2. Mission/Office Professional Staff Person-Days (estimate) <u>10 person/days</u>			3. Borrower/Grantee Professional Staff Person-Days (estimate) <u>120 person/days</u>	

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USAID EVALUATION SUMMARY PART II

J. SUMMARY OF EVALUATION FINDINGS, CONCLUSIONS AND RECOMMENDATIONS (Try not to exceed the 3 pages provided)

Address the Following items:

- * Purpose of activity(ies) evaluated
- * Purpose of evaluation and Methodology used
- * Findings and conclusions (relate to questions)

* Principal recommendations

- * Lessons learned

Mission or Office: USAID/G-CAP / TRI

Date this summary prepared: 02/24/94

Title and Date of Full Evaluation Report:

An Evaluation of the Fiscal Administration Project for USAID/Guatemala-Central American Programs, February 4, 1994.

The FAP was a \$12.4 million project implemented in 5 1/2 years by Peat Marwick. The purpose of the project was to assist the GOG in a comprehensive modernization of its fiscal administration systems.

The purpose of this close-out evaluation was to provide USAID/G-CAP with a complete analysis of the impact of the implementation of the FAP, to evaluate the high return activities performed in light of the original design and of the project extension, to measure the accomplishment of targets and end of project status (EOPS), to determine what still needs to be done apart from what had been already accomplished (e.g. additional procedures and processes required to fully institutionalize recent functional and organizational changes).

The methodology used by IMCC was to first compare the terms of reference for the project with activities and accomplishments in each phase. Second, was to examine the project within a broader context existing in Guatemala specifically within the Ministry of Finance (MOF). Third, the achievements and remaining difficulties were compared with USAID'S end of project conditions specified in the terms of reference for this evaluation and in the project papers. This evaluation occurred in October and November, 1993 and involved interviews with personnel from USAID, Peat Marwick, Georgia State University, and the MOF, in Guatemala, Washington and Atlanta.

The main conclusions of the evaluation were:

The FAP has been a relatively successful project. Some of the most important contributions are:

- Significant input to the GOG's tax modernization program. New tax laws, covering Guatemala most important taxes (VAT, Income Tax)
- Computerized systems in the MOF have been modernized
- A number of control systems have been put in place to assist the MOF in managing tax related matters
- Training has occurred in almost all functions of the Internal Revenues Directorate (DGRI) and Customs Directorate (DGA)
- The Dirección de Análisis Fiscal has been established and its staff trained and equipped by the FAP to provide assistance to the Minister in the formation and management of fiscal policy

Institutionalization of changes wrought by the FAP have occurred in many ways. Signs of institutionalization include:

- The computer section in the DGRI (the Departamento de Informática) is staffed by people trained by the FAP and well equipped to perpetuate the improvements initiated by the project
- The Ministry has committed its own resources to following up on measures suggested or initiated by the project

Nevertheless, institutionalization remains fragile and partial. Signs of this include:

- Not all divisions within the MOF have been objects of the modernization brought by the FAP
- Duplicate responsibilities remain in some areas, and responsibilities are not always clear
- Personnel have been upgraded and numbers increased with the use of special contracts rather than hiring through the civil service
- Much progress has depended on the good will and support of the Minister and Vice Minister

Some of the most important problems remaining are:

- The Tax Code is very awkward and does not support effective tax administration
- Tax Audits are still very weak
- A functional reorganization of the DGRI and DGA
- Greater institutionalization of efficient procedures has occurred in DGRI than in other areas of the MOF, this situation doesn't help to move at the same speed the implementation of all the activities -- The DGA administration will probably deteriorate without the FAP
- Tax revenues are not increasing as they should

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The major recommendations are:

- Conditionality might be used to strengthen institutionalization in the short run. International organizations offering financial support to Guatemala may provide short-run assistance to reform by making their assistance conditional upon factors that help guarantee the survival of measures that have not yet been completed and/or which are in a potentially precarious position.
- The Dirección de Análisis Fiscal has not yet fully developed as a source of sound fiscal advice to the Ministry. They should be encouraged to focus on specific fiscal issues. They should not expand their activities outside of this area. Additional analytical training and/or personnel are needed.
- Auditing is a weak link, and additional support for it is required. Indeed, a project could be mounted specifically aimed at auditing.
- The Tax Code makes the work of auditors and collections much more difficult than they need to be. The tax code should be modified to make procedures straightforward. Reasonable fines for non-compliance should be imposed, and imposition of them should be simple as well.
- If there is additional assistance it should focus on administering the Income Tax and the VAT, or on customs. It should not extend to taxes that have not already been the objects of FAP attention. The VAT and the Income Tax are adequately designed and have broad bases. If they fail to provide adequate revenue it will be due to lack of will on tax enforcement. Attention to other taxes will encounter the same lack of will.

The main lessons learned from the FAP are:

- The original design of the project took into account structural problems in the fiscal area and the administrative problems of the MOF. This design guaranteed the attention and support of the GOG for the project. Any Minister would find the same problems (e.g. low revenues, lack of clear fiscal laws, lack of updated fields, high expenditures, low trained personnel, etc.) and would look for the same type of solutions (e.g. ways to increase revenues, straight out fiscal laws, systematization of functions and activities, etc.). This design facilitated the implementation of the technical assistance and helped to achieve all the purposes of the project. The design team was comprised of MOF staff (Minister, Viceministers and Internal Revenue Director), Peat Marwick experts, Georgia State staff and USAID/G-CAP.
- The FAP was considered by the MOF authorities as its own project. This "ownership" made the work of the consultants more easy and accurate. The MOF authorities shared confidential information with the Peat Marwick team, allowed the team to be part of sensitive negotiations and requested the team's participation in the design of fiscal policies. However, day-to-day work of the Ministry should not be the responsibility of a technical assistance team.
- Even though there was frequent rotation of high authorities in the MOF, the project received a lot of attention and support especially during the last three years. The first Viceminister was designated as counterpart for the FAP, which facilitated timely budget, assignments, counterpart contribution higher than it was originally estimated from \$6.0 million to \$10.0 million, staff support, etc.
- One of the great defects of the project was the lack of a designated MOF technical team from the beginning of the FAP. It would have been more effective to have a team in place early on to receive from the Peat Marwick consultants the knowledge and experience, so that at the end of the project, the continuity and sustainability of the FAP would be guaranteed.
- A need was identified for more coordination among other donors through a technical assistance fiscal strategy. The MOF needs to develop its own fiscal strategy in order to get better results in the implementation of its policy.

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K. ATTACHMENTS (List attachments submitted with this Evaluation Summary; always attach copy of full evaluation report, even if one was submitted earlier)

Evaluation Final Report
SOW / PIO/T

L. COMMENTS BY MISSION, USAID/W OFFICE AND BORROWER/GRANTEE

IMCC did a good job identifying the major issues, concerns and achievements of the FAP. They showed a broad knowledge of the area and understanding of the project. IMCC related very well with MOF authorities, USAID Mission and the Peat Marwick team.

The Mission agrees with the major findings and conclusions of the evaluation team, including:

- Other donors must improve coordination among themselves in order to work in areas that are complementary of the areas covered by the FAP (eg. budget, payroll, etc.)
- MOF should maintain its support to the FAU to strengthen its role as assessment unit on fiscal matters for the MOF authorities
- MOF must develop good coordination with Ministry of Economy and Bank of Guatemala in order to implement a clear macroeconomic policy for the country
- USAID/G-CAP through its economic office can offer to the MOF technical assistance to help the MOF to follow-up the implementation of its fiscal policies

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FAP CLOSE-OUT EVALUATION

The purpose of this document is to present the Scope of Work for the close-out evaluation of the Fiscal Administration Project -FAP-(520-0371). This scope of work contains the following sections:

- I. ACTIVITY TO BE EVALUATED
- II. BACKGROUND
- III. PURPOSE/OBJECTIVE
- IV. STATEMENT OF WORK
 - A. Project Design Evaluation Issues
 - B. End of Project Evaluation Issues
 - C. Evaluation Methodology
 - D. Team Composition
 - E. Level of Effort and Time of the Evaluation
 - F. Project Parameters
 - 1. Objective of the Project
 - 2. Goals Achieved
 - 3. Evaluation Mechanisms
 - 4. Project Outputs
 - 5. Inputs
 - 6. Evaluation Team Review with USAID Project Team
 - 7. Evaluation Reports

BUDGET ATTACHMENT II

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I. ACTIVITY TO BE EVALUATED

Project number	520-0371
Title	Fiscal Administration Project
Cost	USAID US\$12.4 million
Counterpart	US\$ 6.0 million
Life of Project dates	Authorization 07/28/89 PACD 12/31/93

II. BACKGROUND

In January 1990, USAID/Guatemala signed a contract with Policy Economics Group KPMG Peat Marwick to provide technical assistance and training to the Ministry of Finance (MOF) under the Fiscal Administration Project (FAP). In August 1991 the Government of Guatemala (GOG) submitted a proposal for a major reform of the Guatemalan tax system. In July 1992 the Congress approved the Tax Package, that reformed the five main fiscal laws for Guatemala: Value Added Tax (VAT), Personal and Corporate Income Tax (ISR), Stamp Tax, Petroleum Tax and System of Tariffs.

As the GOG proposal became law, the next step was to operationalize the new tax measures, provide training and workshops on both administrative and policy aspects, improve efficiency and analytical capability, and the creation and operationalization of the Fiscal Analysis Unit to carry on the analytical and policy dimensions and foster public awareness and debate on key fiscal issues. Behind this package there were several years of intensive study, analysis and critical judgements much of it sponsored by USAID/Guatemala through technical assistance to the MOF under FAP.

The extension of the Fiscal Administration Project in 1992 was based upon the analysis done on the implementation of the project. This analysis showed that while the development of the tax reform program was successful, the institutionalization of the analytical capacities of the program was weak. A number of factors explain that deficiency. Delays in the original design of the project resulted in the bulk of the Project being implemented during the election year 1990. Not only did the policy framework of the GOG weaken but considerable instability in government personnel occurred. Project advisors worked with

five different Ministers of Finance and innumerable staff members. With each change in Minister the Project Advisors had to educate the Minister, explain that the project was non-political and that tax reform benefits all political parties. Although the Advisors were at the ministerial level, the identification of counterparts in the Ministry and the establishment of an effective training plan greatly suffered.

After this analysis was done it was decided that the project extension was going to be centered around the factors needed to ensure that the final fiscal reform package was successfully implemented, that trained staff remained in MOF, and that MOF developed a strong analytical base to continue public dialogue and administrative refinements.

III. PURPOSE/OBJECTIVE

The purpose of this close-out evaluation is to provide USAID/Guatemala with a complete analysis of the impact of the implementation of the FAP, to evaluate the high return activities performed in light of the original design and of the project extension, to measure the accomplishment of targets and end of project status (EOPS), to determine what still needs to be done apart from what had been already accomplished (e.g. additional procedures and processes required to fully institutionalize recent functional and organizational changes).

IV. STATEMENT OF WORK

The close-out evaluation of the FAP is to provide USAID and GOG offices with information about key issues associated with the project. The broad issues to be evaluated relate to the project's relevance, effectiveness, efficiency, impact and sustainability.

The close-out evaluation will start with the original conditions at the time of design, the assumptions employed and the original goal, and will continue with the project paper amendment, the new objective, purpose, output and input relations, and the expected end-of-project status (EOPS).

A. Project Design Evaluation Issues

Specific questions to be answered by this evaluation include:

- Development of fiscal policy and its priorities

- Since the implementation of the project specified changes in the nature and size of the problems addressed
- Changes in budgetary planning and expenditure administration system
- Specific project targets, as defined in EOPS
- Technical assistance, training and commodity needed and purchased for the implementation of the project.
- Performance of collateral projects, progress and policies contributing to the same sectoral goal

B. End of Project

The evaluation team will determine project's effectiveness by analyzing the three main components developed and implemented during the life of the project (development of the Fiscal Analysis Unit, implementation of the reformed tax legislation and training), and addressing the following issues:

- Implementation of the tax modernization program
- Determine project effectiveness in the application of the analytical models, administrative reforms and training given by the technical assistance team
- Assistance in developing the analytic infrastructure necessary for the Guatemalan public and private sectors to analyze the national budget
- Training plans and programs developed and carried out
- Contribution to building institutional infrastructure
- Donor coordination/Private sector participation
- Performance of collateral projects, programs and policies contributing to the same sector goal
- Improvements in tax administration

- Impact on beneficiaries through tax revenue collection and expenditures
- EOPS of the log frame achieved at the end of the project
- How did the project fit into the political strategy of the government?
- Mechanism developed within the project to monitor its implementation
- Evaluate the main results that the GOG expected from this project
- How administrative processes were improved
- To what extent has personnel turnover (within MOF, USAID or the TA Team) affected project implementation in terms of continuity in perception of project purpose and goals as well as in administrative procedures?.
- On the expenditure side, what were the main results out of this project? What were the improvements on the budget design, administration, implementation and controls?
- What were the achievements for the budgetary analytical infrastructure?
- What additional inputs, apart from programmed counterpart inputs, were required from the GOG to end the project?
- What evidence exists that FAP contributed to higher level USAID/Guatemala Mission objectives?
- What relevant lessons can be drawn from the experience in this project?
- Did the project promote recovery and economic growth in the Guatemalan economy? Is higher economic growth anticipated to come as a result of the project?

- Is the reformed structure and administration of the Guatemalan tax system sustainable in the future without further USAID assistance?.
- Were the project inputs appropriate, in terms on nature, quality and quantity to meet the stated goal of the project?.
- Should more assistance be provided for continued policy reform and/or administration?.

IV. EVALUATION METHODOLOGY

The contractors shall submit, as part of their proposal and initial work plan (see reports section), recommended evaluation methods and procedures to be used. The evaluation methods likely to be used include:

Review of FAP project paper and project paper amendment, contract and subsequent amendment with KPMG, records and documentation (both USAID and Grantee), and periodic reports and assessments.

Interview key personnel in: MOF (Customs, Budget, Internal Revenue), USAID officials, project technical assistance team in the U.S. (Washington and Atlanta) and in Guatemala.

Analyze data and information on economic, social and fiscal performance.

Because of the broad policy reforms resulting from the implementation of the FAP and the project's goal of promoting recovery and broadbased growth in the Guatemalan economy, it will be necessary for the evaluation team to first determine empirically whether the Guatemalan economy "recovered and grew" during the project period and, more importantly, what portion of this recovery and growth can be attributed to FAP.

It is anticipated that the close-out evaluation will begin in September 1993 and will require approximately one calendar month to be completed.

V. TEAM COMPOSITION

It is expected that a 4 person team will be required on a full time basis for this close-out evaluation. All the team members should have prior project evaluation experience, strong and demonstrated analytical ability.

In addition to project evaluation experience, the evaluation team must possess the following skills and experience:

- Public finance economics
- Tax policy
- Tax administration and budget administration
- Training
- Information systems

The evaluation team will work together full time throughout the estimated one month evaluation period.

VI. LEVEL OF EFFORT AND TIME OF THE EVALUATION

The evaluation is expected to last a total of 4 weeks. The whole team will spent one week in preparation and site visits in the US; 2 weeks in Guatemala with the Ministry of Finance , technical assistance team members and USAID officials and to prepare and present to the MOF personnel and USAID officials a draft of the report; 1 week at home offices for final report writing and a one week trip by the team leader for final presentation. A total of 25 work days for the team leader and 20 days for each of other consultants are expected to be provided under the contract. A six day work week is authorized (subject to RCO approval).

VII. PROJECT PARAMETERS

A. Objective of the Project

The objective was to assist the GOG in a comprehensive modernization of its system of fiscal administration. The project as originally designed had four specific objectives:

1. Improvements in the allocation of resources
2. Greater equity in the distribution of tax burdens and expenditure benefits
3. Mobilization of resources to cover the cost of public services
4. Improved GOG ability to plan and monitor its fiscal decisions

B. Goals Achieved

The original goal was to support the GOG'S efforts to stimulate robust economic growth, with a tax structure reflecting broad participation in the Guatemalan economy of the public and private sectors. The close-out evaluation team will need to consider the evolving role of the fiscal administration project in the Guatemalan economic development context in order to find out the goals achieved by the project.

C. Evaluation Mechanisms

In terms of methodology of evaluation, the team will utilize the original project paper and the project paper amendment for end-of-project status indicators, rely on project reports from the contractor and USAID, examine baseline and subsequent data on past and current fiscal policy and performance, and the implementation and application of the various analytic models. Interviews with key GOG officials, AID project officers and members of the technical assistance team will be essential.

D. Project Outputs

Project outputs identified at the point of design centered around the analysis of the Guatemalan fiscal system; the construction of analytical models to assist in the understanding of impacts from policy reform measures; and, operational and administrative improvements. The evaluation team will examine the close-out activities of the project.

1. Analytic models developed and installed in Guatemala:

- Microsimulation
- Forecasting
- Marginal effective tax rates
- Computable General Equilibrium model
- Effective protection
- Taxpayer ID

2. Specific analyses completed:

- Fiscal reform concept paper
- Fiscal incentives
- Tax burdens/benefits

3. Improved operational and administrative effectiveness of MOF's fiscal administration.

- Income taxation
- VAT and other indirect taxes
- Customs
- Budget

4. Creation of the Institute for Fiscal Analysis within MOF

E. Inputs

The FAP was envisioned as a collaborative effort between US-supplied technical assistance and key personnel of MOF.

Inputs supplied by the United States and the GOG

USAID

GOG

- | | |
|-----------------------|---------------------|
| -Technical assistance | |
| -Training | -Training |
| -Commodities | -Commodities |
| -Evaluation/audit | -Logistical support |

The team will evaluate the past inputs from both the USG and GOG in terms of their quality, quantity and effectiveness.

F. Evaluation Team Review with USAID Project Team

Before leaving country to draft the evaluation report, the evaluation team will conduct a review with key USAID officials:

1. What will the project have achieved by PACD?.
2. How does achievement compare to plans?.
3. Did the project achieve its purposes?.
4. What have been the unplanned changes and their effects?.
5. What were the impacts of the implementation of the FAP in the Guatemalan economy?.

4

G. Evaluation Reports

The contractor will be expected to provide a series of reports on the close-out evaluation, as indicated below:

1. Report outline will be prepared before arriving in country, and will serve as a principal basis for discussions and planning.

2. The consultants shall provide USAID/Guatemala with a workplan, detailed schedule, methodology, list of proposed interviews, site visits, and assignment of team member responsibilities within three work days after arriving in country.

3. The consultants shall provide USAID/Guatemala with a oral briefing and draft report after the initial US-based study and also before leaving country. The draft report will include the points discussed in the exit review as well as the following:

- Executive summary - states the development objectives of the project being evaluated; purpose of the evaluation, methodologies, findings, conclusions, recommendations, and lessons learned about the design and implementation of this type of activity.
- Project identification data sheet
- Table of contents
- Body of report, that include discussions of:
 - Purpose of the close-out evaluation
 - Economic political and social context of the project
 - Team composition and methodologies
 - Evidence/findings of the assessment
 - Conclusions drawn from the findings
 - Recommendations based on the assessment
- Appendices including a copy of the close-out evaluation scope of work, list of documents consulted, and individuals and agencies consulted. Additional appendices may include a brief discussion of methodologies and technical topics if necessary.

4. AID review will be conducted after the draft is presented together with the exit conference.

5. The consultants shall provide USAID/Guatemala with a final report within 15 work days, after receiving USAID/Guatemala comments on the draft report. The final report will incorporate AID comments and be produced in both English (original and 5 copies) and Spanish (original and 5 copies). Diskettes with report files in mutually agreed upon software language will also be delivered.

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IMCC

**AN EVALUATION OF THE
FISCAL ADMINISTRATION PROJECT
FOR USAID/GUATEMALA**

by

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EXECUTIVE SUMMARY

This study evaluates the Fiscal Administration Project, (FAP) supported by USAID/Guatemala. The project occurred in three phases. The original project occurred during the calendar years 1990-91. A "no-cost extension" occurred during the first six months of 1992. A major extension covered the period July 1992, to the end of 1993. The FAP was conducted for AID by KPGM Peat Marwick, with a subcontract to Georgia State University. Overall, FAP objectives were:

- improve the allocation of resources in Guatemala,
- achieve greater fairness in the distribution of tax burdens and expenditure benefits;
- mobilize resources to cover the cost of public services,
- improve the government of Guatemala's (GOG) ability to plan and monitor its fiscal decisions.

Our methodology was to first compare the terms of reference for the project with activities and accomplishments in each phase. Secondly we examined the project within a broader context existing in Guatemala and specifically within the Ministry of Finance (MOF). Third, we compared the achievements and remaining difficulties with AID's end of project conditions specified in the terms of reference for this evaluation and in the project papers. The evaluation occurred in October and November, 1993, and involved interviews with personnel from AID, Peat Marwick and the MOF, in Guatemala, Washington and Atlanta.

The terms of reference for the FAP called for work in eight areas. These are:

1. Policy analysis
2. Income tax administration
3. VAT administration
4. Customs administration
5. Budgeting
6. Organization and Management
7. Computerization and information systems
8. Training

In general, the FAP team has fulfilled almost all components included in the terms of reference. Omissions have been few (eg. limited activity in budgeting; the production of a "White Paper" on fiscal policy in Guatemala) and several important activities have been added that were not specified in the terms of reference. Furthermore the team has played a key role in the implementation of the tax modernization program, the centerpiece of which is the new tax laws signed by the President in May 1992. The team worked on many day-to-day implementation tasks in the Ministry, responded to the direct needs of the Minister and Vice Minister, and took the lead in establishing regulations to fit the new tax laws. Other major accomplishments of the FAP included establishment of the Dirección de Análisis Fiscal (DAF) and installation of modern computerized information systems.

The Fiscal Administration Project has been a relatively successful project. Some of the most important contributions of the FAP are:

- **Significant input to the GOG's tax modernization program.** New tax laws, covering Guatemala's most important taxes (IVA, Income Tax), and implementing regulations were designed, and written primarily by FAP advisors.
- **Computerized systems in the Ministry of Finance have been modernized.** Data management is now much improved over the old mainframe environment.
- **A number of control systems have been put in place to assist the MOF in managing tax-related matters.**
- **Training has occurred in almost all functions of the DGRI and DGA.** This is particularly the case in computerized operations and auditing.
- **The Dirección de Análisis Fiscal has been established and its staff trained and equipped by the FAP to provide assistance to the Minister in the formation and management of fiscal policy.**

Institutionalization of changes wrought by the FAP have occurred in many ways. Signs of institutionalization include:

- **The computer section in the DGRI (the Departamento de Informática) is staffed by people trained by the FAP and well equipped to perpetuate the improvements instigated by the project.**
- **The Ministry has committed its own resources to following up on measures suggested or initiated by the Project.**

Nevertheless, *institutionalization remains fragile and partial.* Signs of this include:

- **Not all divisions within the MOF have been objects of the modernization brought by the FAP.**
- **Duplicate responsibilities remain in some areas, and responsibilities are not always clear.**
- **Personnel have been upgraded and numbers increased with the use of special contracts rather than hiring through the civil service. Reallocation of budgets could easily terminate this practice.**
- **Much progress has depended on the good will and support of the Minister and Vice Minister. Changes in the occupants of these positions could shift support to other areas.**

Despite the FAP activities, *the ability of the MOF to administer taxes remains weak in many ways.* Very little improvement has been institutionalized at the DGA. Organizational changes recommended by the FAP have generally not occurred. Auditing remains a very weak activity. The MOF appears to pay very little attention to the detail that would allow them to bring to bear the many tools provided by the FAP. The DAF is still too weak to provide much substantive

input into policy making. *Some of the most important problems remaining are:*

- **The Tax Code** is very awkward and does not support effective tax administration.
- **Tax audits** are still very weak.
- A **functional reorganization** of the DGRI and DGA have never occurred.
- **Greater institutionalization** of efficient procedures has occurred in DGRI than has been the case in DGA.
- **The DGA administration** will probably deteriorate without the FAP.
- **There is little attention to detail and organization** at most levels in the DGRI, DGA and elsewhere in the MOF.
- **Optimism at the MOF** that all will go well after the FAP leaves is probably unfounded.
- **Tax revenues** are not increasing as they should.

While it is not the intention of USAID to extend the FAP it may be useful to other organizations to identify measures that should be taken as natural follow up on the FAP project. Some areas that might prove useful are the following:

- **Conditionality** might be used to strengthen institutionalization in the short run.
- **The Dirección de Análisis Fiscal** has not yet fully developed as a source of sound fiscal advice to the Ministry. Additional analytical training and/or personnel are needed.
- **Auditing** is a weak link, and additional support for it is required.
- **The Tax Code** makes the work of auditors and collections much more difficult than need be. The tax code should be modified to make procedures straightforward.
- **If there is additional assistance** it should focus on administering the Income tax and the VAT, or on customs. It should not extend to taxes that have not already been the objects of FAP attention.

Achievement of the main FAP objectives can be summarized as follows:

- **Improve the allocation of resources** in Guatemala, has been very limited. The FAP has had little influence on budgets and improvements in the tax structure are very imperfectly administered.
- **Greater fairness in the distribution of tax burdens and expenditure benefits**, has probably not occurred, despite improvements in the tax structure which should promote greater fairness.

- Mobilization of resources to cover the cost of public services has improved. The improvement is due to changes in the tax structure rather than to changes in tax administration.
- Improvements in the government of Guatemala's ability to plan and monitor its fiscal decisions has occurred. This is largely due to the establishment of the DAF.

Overall, the problems of tax administration probably outweigh what has been achieved. A significant number of tools have been made available by the FAP and the Ministry's staff has been upgraded. However, much of the improved staff is temporarily paid through special contracts. Many of the tools are not being used to their full potential, and many of the uses made of the tools seem to be at the prodding of the FAP team. We fear that when the FAP team leaves, some of the tools will not be used. Meanwhile the Ministry seems complacent. There is overoptimism that things are going well because tax revenues are increasing. Closer examination reveals that that may not be the case. There is also overoptimism that the computerized tools created by the FAP can do more than is reasonable. The tools must be used and maintained. The work of tax administration must still be done by Ministry personnel paying attention to the details of administration (which the tools make easier). Ministry personnel seem to think that somehow the tools will do the work automatically. Unfortunately within the MOF there seems little appreciation for what remains to be done.

I. INTRODUCTION AND METHODOLOGY

The Fiscal Administration Project (FAP) began in January 1990 and occurred in three phases. The original FAP was designed to end in January 1992, but a second phase occurred when a "no cost" extension pushed the terminal date to June 31, 1992. A major extension was granted later, to continue the project from July 1, 1992 through October 1993. (Another minor "no-cost" extension allows the project to wind down through December 1993.) The FAP was designed to offer assistance to Guatemala's Ministry of Public Finance (MOF) in a range of activities aimed at improving fiscal performance. USAID contracted KPMG Peat Marwick, Policy Economics Group, along with sub-contractors associated with Georgia State University, to act as direct advisors to the Ministry of Finance. Overall, FAP objectives were:

- improve the allocation of resources in Guatemala,
- achieve greater fairness in the distribution of tax burdens and expenditure benefits,
- mobilize resources to cover the cost of public services,
- improve the government of Guatemala's (GOG) ability to plan and monitor its fiscal decisions.

In August 1991, the GOG submitted a proposal to the Congress for a major reform of the Guatemalan tax system. Many of the elements in the reform package were designed with the help of the FAP advisors. The reform proposals advanced through the Congress and were eventually signed into law by the President in May, 1992. As the proposals became laws there were needs to implement their provisions, train personnel in administrative and policy aspects, and in general to put the new set of tax laws into effect. While most elements in the FAP serve the interests of those who are implementing the new tax laws, other needs remain unserved. This study will attempt to identify what remains to be done.

This study has as its main objective the evaluation of the FAP relative to its original goals and objectives. There are two ways the evaluation can proceed. *First*, one can focus on the scopes of work as originally stated in the project papers upon which the project was based¹. These after all were the conditions that created the terms of reference under which the main contractor, KPGM Peat Marwick operated. *Second*, USAID has broader interests in its projects, and some of these are offered as evaluative criteria in the terms of reference for this evaluation. *Our procedure* is to review the project *vis-a-vis* the terms of reference given to Peat Marwick, so that we can see how the work developed. Then we consider the broader issues raised by AID. A secondary objective is to identify what remains to be done, and we do that last. The focus there is on the priorities for improving fiscal administration in Guatemala, given the contributions

¹ See: Guatemala Project Paper, Fiscal Administration, Project Number 520-0371, July 1989, AID/LAC/P-475, and Guatemala Project Paper, Fiscal Administration Amendment Number 1, Project Number 520-0371, March 27, 1992, AID/LAC/P-727.

already made by the FAP.

The text of this report follows these objectives. In Section II, is an evaluation of the original FAP² and Section III evaluates the FAP during the first, "no-cost" extension occurring during January-June 1992. Section IV is more ambitious since the major extension, occurring between July 1992 and October 1993 was guided by somewhat different terms of reference. Section V sums up by identifying the major accomplishments and persistent problems at the MOF. Section VI examines the broader issues appearing in the terms of reference for this evaluation and Section VII makes recommendations. Recommendations are of two kinds. First there are recommendations for the design of projects on fiscal administration. Second, there are those on what remains to be done.

The methodology for this evaluation was a comprehensive one. All original project papers were examined. All reports produced by FAP and its consultants were read and evaluated and all models were examined (to the extent that they are documented). Interviews were conducted with most FAP participants including the Peat Marwick teams in Guatemala, Washington and Atlanta. A long list of Guatemalans were also interviewed. All persons interviewed are listed in Appendix A. Project activities and accomplishments were then compared to the actions and objectives stated in the terms of reference given to Peat Marwick for each phase of the project. This part of the work is a somewhat mechanical comparison of objectives and achievements. Beyond this there is also an evaluation of how tax administration functions in Guatemala in general and what the remaining weak links are in the efforts to put the country's public finances on an equitable and efficient footing.

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² A full evaluation of the FAP was conducted in December 1991. (see Loehr and Mann, 1992) We do not want to repeat that entire exercise, so much of Section 2 summarizes that work.

II. THE ORIGINAL FISCAL ADMINISTRATION PROJECT (FAP)

The original Fiscal Administration Project (FAP) was fully evaluated in December 1991. It would be a waste of resources to fully review that period of the project's life again. For the details are readily available. (see Loehr and Mann, 1992) Nevertheless, some revisiting is useful for the current report, since many of the recommendations made in December, 1991, were incorporated in the project extensions. Review of the original FAP is also necessary for an understanding of why the project was extended and why the scope of the extension was as it was.

The objective of this section is to summarize the findings of the December 1991, evaluation. To do this we *first* compare the FAP activities actually carried out (as of December, 1991) with the scope of work specified in the original Project Paper (dated July, 1989). *Secondly*, comments will be made about the extent to which the project met the goals and objectives initially specified. *Third*, we present a brief wrap-up of the FAP's overall performance. *Fourth* and finally, recommendations for extensions of the project are reviewed.

A. Scope

The original scope of work called for activities in four general areas:

1. *Models* - A series of analytical models were specified. These were to be designed and installed at the MOF, along with requisite training in their use.
2. *Specific studies* were to be done on topics of interest to the Guatemalan tax system.
3. *Operational and administrative assistance* was to be provided by the FAP team.
4. *An institute for fiscal analysis* was to be formed, equipped and trained.

1. Models

Prior to the development of formal models to analyse the Guatemalan tax system, the FAP team was to prepare a concept paper "describing the fiscal system, measuring and evaluating its performance and analyzing the extent to which it fits the government's general economic and social development program". This paper was to form the background for a White Paper on fiscal policy and administration, and by the end of the FAP the White Paper was to be converted into a "full-fledged policy paper on comprehensive Fiscal Policy and Administrative Reform in Guatemala". Although the concept paper was developed in draft form, it was not circulated. It was delivered to the Minister of Finance who chose to keep circulation to a minimum and the paper was not published. The so-called "White Paper" was on fiscal policy was to come at the end of the project to sum up and set the stage for the future.

Modelling activity was aimed at the development, installation, and application of a set of micro-simulation tax models to buttress the formulation of tax and budget policies. Models were contemplated in the following areas:

1. **A personal income tax model.** This is a micro-simulation model used to analyze the revenue and distributional effects of alternative personal income tax policies. By December, 1991, the model was well advanced in its development. It was installed in the FAP office at the Ministry and a users' manual and technical description were in draft form.
2. **A business income tax model.** The model was divided into two parts, with a corporate income tax portion being channeled into a separate business income tax model and a VAT portion to provide input to the indirect tax model described below. By December, 1991, most work was in draft form and installation in the MOF had not yet been done.
3. **An indirect tax model** is an economy-wide model incorporating all indirect taxes (ie. customs duties, VAT, excise taxes, miscellaneous taxes and fees). The model's construction, its database, extrapolation, menu system, and technical description had been completed by December, 1991, but it was not yet installed in the FAP office nor in the MOF.
4. **A public revenue forecasting and tracking model.** This model forecasts tax receipts, converts tax liability into tax collections and monitors actual collections against estimates. The model construction and its database were complete in December 1991,, but its documentation and installation were not.
5. **A computable general equilibrium model** is an economy-wide model designed to analyze the effects of alternative tax and economic policies. The model had been completed prior to December, 1991 but its database was incomplete.
6. **A system for computing effective rates of protection (ERP)** was specified as one of the analytical tools sought in the Project Paper, but rather than appearing as a separate system, ERP calculations were embedded in the indirect tax model.
7. **Calculation of Marginal Effective Tax Rates (METRs).** This model was not produced. Though calculation of METRs for Guatemala, were carried out (Technical Memorandum #13), the state of data in Guatemala limited practical results from further model development.
8. **Creation of a taxpayer identification system.** Early in the FAP's life it was decided that a collateral BID/CIAT project would take on the responsibility for creating the system of taxpayer identification, something which that project had begun before the FAP began.

Two models which did not appear in the original terms of reference were developed by the FAP. An *oulay forecasting model* which forecasts the current public services budget was nearing completion at the end of 1991. This model was added as a useful compliment to the public revenue and forecasting model. The "*Cobranza*" model is a computerized tracking system for

following up on audit-generated, tax deficient cases.³

In summary, on model development, the FAP accomplished most of what it set out to do. Models of highest priority were developed. Models which were not developed would have had little payoff (eg. for calculating METRs), were embedded in other models (eg. ERPs) or would have duplicated work being done elsewhere (eg. Taxpayer ID systems). Furthermore, the FAP took the initiative to produce models not called for in the original project paper, but which appeared to be a useful extensions of other work. Given the Ministry's ability to run, update and use formal models at that time, the FAP probably produced more models than could be used. In retrospect, the Project Paper was probably optimistic in its expectation that the MOF could use models and the FAP overly ambitious in providing modelling capability for the MOF.

2. *Specific Analyses*

The original Project Paper called for specific analyses of fiscal policy issues. These were chosen to provide background data and analysis to fit the various pieces of the fiscal system and to encourage an on-going discussion of comprehensive fiscal reform scheduled for 1992. These analyses were to examine the relationship between fiscal policy and other key elements of overall economic policy, and address issues of tax and budget administration. Most of the analyses were presented in a series of Technical Memoranda (TM), a full listing of which appears in the Appendix. As of December, 1991, the first 23 TMs were completed. Seven areas were identified by the terms of reference for specific analysis. These and their descriptions from the terms are:

1. **Analysis of Fiscal Policy Influences on Economic Structure.** This was "to provide technical assistance to the MOF to examine four topics in the field of fiscal incentives in Guatemala: (a) the costs of fiscal incentives in terms of revenue lost; (b) the effectiveness of the incentive regimes in achieving their objectives and the value of these incentives in attracting investment; (c) the exemption structure (total or partial); (d) the foreign tax credit implications of incentives." These analyses were conducted in TM 2, 10, 13 and 14.

³ Cases where audits are in process must pass through dozens of steps before the taxpayer can be assessed the appropriate amount of tax or prosecuted for non-compliance. Unless these cases are carefully followed, the statute of limitations may run out before the legal procedure runs its course. Indeed, in the past, delinquent taxpayers could almost count on the statute of limitations expiring before an audit was completed. With the Cobranza model, auditors and their supervisors can see where all cases are in the process, what remains to be done, what the potential payoff is and how much time remains to finish the audit. In this way it is easier to manage the audit process to ensure that all important cases are completed within the allowable time period.

2. **Analysis of Tax Burdens and Tax Fairness.** These were to provide "evaluation of the distribution of tax burdens and public expenditure benefits across income brackets in order to estimate the incidence on income groups of the proposed changes in revenue and expenditure policies." No published TM specifically covering this topic has appeared, but the work was partially done in TMs 2, 8 and 13.
3. **Development of a Database on Public Enterprises.** This was to "provide technical assistance to the MOF to (a) collect, standardize, and transform public enterprise data into useful analytic categories that will facilitate the future study of Guatemala's parastatal enterprises; (b) review the adequacy of pricing policies in the public enterprise sector; (c) determine how the parastatal sector can be best integrated into the national budgetary system. Points (b) and (c) but not (a) were covered in TMs 4 and 21.
4. **Development of a Work Plan for Fiscal Decentralization.** "To provide technical assistance to the MOF to develop a workplan for fiscal decentralization; i.e., devolving discretionary fiscal powers to the local governments." Little was done under this activity due to change to a Minister of Finance who ordered that the subject be dropped. Prior to that the subject was dealt with in TMs 5 and 23.
5. **Diagnostic of Business Income Taxation and Incentives.** To "analyze the legal aspects of the business income tax in order to correct its unclear statement in the tax statutes, and estimate the economic impact of the tax with respect to revenue yield, efficiency effects, and distributional implications." This activity was covered rather comprehensively via the development of the business income tax and indirect tax microsimulation models, the CGE model, the calculation of the METRs and in TMs 2, 7, 12, 13, 14, 16 and 18.
6. **Diagnostic of the Personal Income Tax.** To "analyze the issues and deficiencies relating to the personal income tax, including the distortions affecting taxpayer behavior (from the income sources and uses side) and the cost of these distortions; design alternative integrated options to the present tax structure." These activities were comprehensively covered via the development of the personal income tax and CGE models and TMs 3, 7 and 10.
7. **Diagnostic of the Property Tax.** To "prepare a joint (with the MOF) technical paper to (a) analyze possible changes in the structure of the property tax to increase its equity and reduce its administrative and compliance costs; (b) quantify the revenue and land use pattern impacts of alternative tax structures; (c) recommend steps to be taken to implement needed improvements in property tax administration." Parts (a) and (c) were completed, but part (b) was not carried out due to the lack of reliable data. See TMs 5 and 23.

In summary, on specific analysis, almost all of the activities specified in the Project Paper were accomplished. The discussion here has not addressed the quality of the technical memoranda that have provided these specific analyses, for this would require considerable space and specialized

skills not entirely represented on the evaluation team. However, all TMs were read by the evaluation team. In the areas of competence represented on the evaluation team, the TMs appeared to be of very high quality. They were well focussed, theoretically sound and offered practical insights. In general, the specific analyses produced by the FAP well served the original intentions specified in the Project Paper.

3. *Technical Assistance in Operations and Administration*

The operations and administration component of the FAP is the major focal point of the project. This covers such areas as helping to modernize administrative processes, providing training, carrying out planning, and involving itself in daily MOF activities. Tax administration/operations issues are not distinct or even separable from those involving tax structure/policy. Nevertheless, it has generally been the case that the administrative dimension has received far less consideration in fiscal policy analyses than can be legitimately justified. After all, at the core, tax/fiscal administration is tax/fiscal policy. A theoretically "optimal" tax structure is useless in the face of the typically weak administrative processes that characterize countries like Guatemala. Thus, it is to the credit of the FAP that these critical aspects were not overlooked or given secondary priority.

Project activity was originally aimed at five areas:

- Income tax administration
- Indirect tax administration
- Customs administration
- Budgeting and expenditure management
- Computerization

A brief summary of what was done in these areas follows:

a. *Income Tax Administration*

Before the initiation of FAP activities in Guatemala's MOF, a very long list of administrative deficiencies could have been made. Wisely, priorities were left to the discretion of the resident advisors once they were in place. Flexibility was almost a requirement under the circumstances. Notable accomplishments included:

- the development and execution of a computerized tracking system for audit-generated tax deficiencies (the so-called Cobranza Project);

- the development and execution of emergency bond and tax amnesty programs in 1991;
- the development and execution of improved processing procedures for the reconciliation of tax receipts collected by commercial banks;
- the development of an organizational restructuring plan for the Internal Revenue Directorate (DGRI);
- conduct a management development training program;
- the development and execution of selected audit programs and audit technique seminars;
- assistance in drafting income tax laws for the tax reform proposals which were brought before the Congress toward the end of 1991.

Some of these activities arose out of current needs of the Minister and/or MOF, and made distinct contributions to short-run GOG and MOF policy; they were not all contemplated in the original Project Paper and contract. Activities which were contemplated in the project paper but were either partially accomplished or not undertaken include:

- execution of a more functional structural organization for the DGRI.
- simplification and expedition of the taxpayer registration process;
- establishment of one MOF unit responsible for non-filer and stop-filer identification;
- establishment of a Collections Department with responsibility for contacting taxpayers in arrears;
- institutionalization of training functions in the DGRI;
- development of a comprehensive auditor training program and evaluation standards for audits.

The main reasons for not meeting originally proposed objectives were a lack of MOF commitment to such programs, the absence of qualified MOF personnel, and the alternative use of the FAP advisors' time on tasks of immediate interest to the Minister(s) of Finance. On balance, considerable short-term administrative strengthening was accomplished, but where more permanent, longer-run impacts might have been generated, progress fell short of original expectations.

b. *Administration of Domestic Indirect Taxes*

The focus of the FAP was almost exclusively on the VAT. The VAT is by far the major indirect tax in Guatemala. Most FAP effort focussed on day-to-day operational improvements, computerization, audit issues and to lead training exercises. Accomplishments included valuable assistance in drafting the proposed new VAT law, the development of control programs for non-filers and stop-filers, and assistance in the execution of a pilot field audit program. Little formal training was implemented, and plans for a structural reorganization of the VAT Department never went beyond the planning stage. What remained to be accomplished in VAT operations/administration was more voluminous than what was accomplished.

c. *Customs Administration*

FAP terms of reference specified that a workplan would be drawn up by the long-term advisors upon initiation of their residence in Guatemala. That workplan was executed on a very limited basis during the project's first year. During that time cooperation between the director of customs and the FAP team was very poor. It was clear that the director of customs did not welcome outside "interference" in customs operations.⁴ With the appointment of a new Director General of Customs in January, 1991, several initial workplan elements began execution. Among the accomplishments (through December, 1991) in customs administration were:

- the implementation of a pilot program to strengthen merchandise transit controls;
- implementation of a system for automatic vehicle clearance;
- creation of a motor vehicle data bank for valuation and classification purposes;
- establishment of a computerized pilot program to control firms benefiting from fiscal incentives;
- on-the-job training for customs employees;
- the design of a proposal for a structural reorganization of The Dirección General de Aduanas (DGA).

If an earlier commitment to the FAP had been made by the MOF and the director of customs, much more would have been achieved. The limited success of the FAP in improving customs administration was due to a lack of commitment in the MOF, not to a deficiency on the part of FAP personnel. On the contrary, the quality of the skills offered by the FAP advisory team in

⁴ The quarterly reports submitted to AID by Peat Marwick reveal continual efforts by the FAP team to offer assistance to customs, only to be rebuffed time and again.

the customs area was very good, and team members aggressively attempted to integrate themselves in customs operations.

d. *Budgeting and Expenditure Management*

The original Project Paper and contract called for FAP technical assistance to the MOF's Technical Budget Directorate (DTP) in the following areas: (a) preparation of a concept paper on budgetary structure; (b) selection and monitoring of core development budget activities; (c) support for creation of a separate Budget Analysis Unit; (d) development of a multi-year budgeting framework; (e) implementation of a budget tracking system; (f) training in program analysis.

Area (a) was fulfilled with publication of several Technical Memoranda (numbers 9, 19 and 20) but activities in areas (b), (c), and (d) were not carried out. Development budgets are done by SEGEPLAN, in the Guatemalan Planning Ministry, not by MOF. The Budget Analysis Unit was not created, the MOF provided no technical support for its creation and did not appoint a counterpart for the task. A multi-year budgeting framework was not developed because it requires coordination of current and capital spending plans between the MOF and SEGEPLAN, and, coordination with SEGEPLAN never came about. Two models have been developed to support a budget tracking system. Training in program analysis was sporadic, as a continuous and permanent training capacity was not developed. DTP personnel received several FAP-sponsored seminars and workshops on financial and revenue programming and program analysis, and some on-the-job training of certain budget personnel occurred.

Although the original project goals were not achieved, the two long-term FAP resident advisors in budgetary matters became involved in varied short-term tasks which left little time for other activities. For example, they became involved in the preparation of a decree which incorporated an emergency bond program in the 1991 budget and in the preparation of two fiscal policy studies. Moreover, an initial workplan elaborated in conjunction with DTP personnel was not approved by the Minister. On the positive side, the FAP played a significant role in totally revising budget presentation. The budget was reduced from an unintelligible four volume, 800 page document to a single, 200-page presentation which provides the entire budget aggregated to appropriate levels and describes the projects and programs the GOG intends to undertake.

e. *Computerization*

The FAP has made significant contributions to fiscal administration in Guatemala in computerization. Even though computerization was not explicitly included in the Project Paper, what was accomplished by late 1991 indicated that this was one area in which the FAP will leave a permanent impact on the MOF.

Until 1990 all data processing in the MOF was done on a mainframe computer located in the

Ministry's basement. This computer served many conflicting needs. MOF needs were not normally granted high priority and service was extremely slow. Some tax data entries were up to two years behind.

In early 1990 the FAP began the decentralization of data processing using a microcomputer network and by November, 1991 about one-quarter of all MOF processes had been converted into a completely decentralized system. This micro solution has provided the MOF with a more flexible, learner-friendly, and efficient data entry/processing system. It also promises less expensive hardware and software costs in the future. Since 1990 all new systems development has been done on microcomputers. Microcomputers are currently used for the data entry of income and sales taxes, income tax withholding, the unique taxpayer number, taxpayer identification data, and most processing for the DGRI. Both formal and on-the-job training have been imparted to MOF personnel.

In summary, the project's major contributions to the MOF's operations and administration prior to 1992 may be summarized as:

- Computerization of the MOF via a microcomputer solution;
- Elevation of the quality of debate on Guatemala's tax system;
- Improvement in taxation analysis via the TMs, and the models;
- Contribute the skills that were needed to design the tax reform legislation presented to the Guatemalan Congress.

The project's major non-accomplishment was:

- Lack of institutionalization.

The latter is of particular concern. The FAP resident advisor staff was constantly caught up in carrying out many of the short-run policy requirements of the Minister(s) and upper-level MOF personnel. Given the general lack of competent MOF personnel, the FAP advisors played the role normally carried out by Ministry staff. Under such circumstances it is to be expected that little heed can be paid to the institutionalization of activities and the required training activities implied. As a corollary, this lack of competent Ministry staff emphasized the future necessity of attracting and employing qualified personnel if there was to be any hope that permanent improvements will emanate from the FAP.

4. *Development of an Institute for Fiscal Analysis*

The Project Paper and contract called for the creation of an Institute for Fiscal Analysis (IFA) within the MOF in order to establish a permanent capacity in that area. The IFA never got off

the ground, although many of the tools (the above-cited models) to be used by it had been developed. The models had been developed by the contractor in Washington and/or Atlanta, in turn-key fashion without any practical input from the MOF. Thus, as of December, 1991, there existed a series of models without anyone in the MOF knowing how these models could be used nor how to run them. Moreover, in the absence of the IFA there was no place to even locate any future model-using capacity. There were numerous "reasons" explaining the failure to establish an IFA. They are all related to the lack of commitment on the part of the MOF to provide people and direction.

B. Progress and Problems

The FAP progress as of the end of 1992 was very little. Future progress depended entirely on GOG and MOF commitment to the project, a commitment which had been sorely lacking up to that point.

The main general problem for the FAP had to do with the MOF environment. The FAP had offered far more than the MOF has been prepared to absorb. The project placed at the disposal of the MOF numerous long-term resident advisors and short-term consultants of top quality, and supported these persons with an excellent corps of personnel in Washington and Atlanta. In the many interviews of MOF personnel done by the evaluation team, high regard for the services rendered by the resident FAP advisors was expressed. Yet, little advantage was taken of these resources by the MOF and the GOG. Little institutionalization occurred, and the long range benefits from the FAP to Guatemala were quite tenuous.

The major specific problems encountered, in more or less their order of importance, included the following:

- First:* Throughout the project there has been little or no MOF commitment of political will, personnel, money and other resources needed to seek the originally established objectives.
- Second:* There were five different ministers of finance during the two years of the project. Each change required that the FAP director and staff re-explain the goals, objectives and methods of the program to each new minister, and solicit his or her support in pursuing project objectives. With each new minister there was a shift in the relative personal interest of the minister in various aspects of the program, and each required some reorientation of the project. This was extremely wasteful of project resources.
- Third:* The project's two-year life straddled two different national political administrations. Delays in the original implementation schedule placed the beginning of the project in an election year. This could have been avoided by better control and planning on the part of USAID.

Fourth: Many tasks were given to the FAP team that were not originally anticipated in the Project Paper. All of these were at the request of ministers attempting to overcome short-run difficulties. Each required extraordinary effort by the team and drew team members away from the original objectives of the project.

Fifth: Often, members of the FAP team were drawn into performing functions for ministers that should have been performed by regular staff members in a well run ministry. Since most ministers were new, and all faced what they considered "emergency" conditions and had limited staff support available, they called on team members to help in what would normally be staff functions. To gain the "confianza" of each minister the project staff pitched in.

C. Overall Evaluation

In terms of the original objectives of the FAP, little of permanance was accomplished. The MOF did not provided appropriate personnel, nor was personnel motivated to run a modern tax administration system. Ministers of Finance were changed so often that no continuity occurred in project direction. Without clear leadership from the minister, little can be expected. It is unlikely that the FAP could have accomplished more than it did given the level of support from the MOF.

The FAP staff accomplished best those tasks which required the least input from the MOF. Technical studies provided excellent insight to fiscal problems in Guatemala and models were created to manage technical detail. Most of this was done in turn-key fashion, with little involvement of the MOF. While most of the formal models had not been fully installed, it was not obvious that the MOF could use them even if they were installed. Indeed, the original project design could be criticized for not anticipating the limited ability of the Ministry to use formal models, and for being overly ambitious in providing formal models. Where greater involvement of the MOF was required, progress was slower. Some administrative advances were made in income taxes, the VAT, and customs. Only in the area of computerization was there the beginnings of a permanent impact as of the end of 1991.

The FAP staff was often exploited by the Ministry to make up for deficiencies in its own staff. The main case in point is the development of the tax reform proposal, which was done almost entirely by the FAP staff rather than by MOF personnel. Many other ad hoc tasks were also given to the FAP team, which were outside their scope of work. Some of these include the Cobranza project, the emergency bond program and the tax amnesty program. Despite the fact that these were not part of the FAP scope, the FAP team had to continually struggle to gain the confidence of new ministers, and refusing to help out in an "emergency" would have doomed the project.

Failure to meet objectives of the project as originally set out cannot be blamed on the FAP team. Peat Marwick assembled a group of very capable and enthusiastic individuals and gave them

access to important resources in Washington and Atlanta. Team members were responsive to MOF interests while continually prodding the Ministry to improve. The FAP team created many opportunities for the MOF to upgrade its capabilities, opportunities that were not taken advantage of.

D. Recommended Directions as of January, 1992

A question before the evaluation team in December, 1991, was whether the project should be extended beyond its originally planned termination date of January, 1992. One option was for a "no cost extension" until the end of June, 1992. Another was for an additional major extension running from July, 1992 through October 1993. In determining whether an extension of the FAP should occur several criteria were applied. *First*, any extension of the FAP should not also be an expansion into areas not already covered by the original project. *Second*, indications of commitment by the GOG and the Ministry of Finance should precede any extension of the FAP. *Third*, any extension of the FAP should be structured so that the project can be terminated in a reasonable way should the required commitment fail to materialize. *Fourth*, elements of the FAP were underway by January, 1992, but that required some extension to bring to a productive end, should be completed. *Fifth*, extensions of the FAP should focus on specific areas of high priority, which had already been the objects of FAP activity.

With these guidelines in mind the extension proposed was composed of two categories of activity.

1. Finishing projects that were already underway, which had a high probability of productive payoff and which could be completed by June 30, 1992. This option was available as a "no-cost" extension of the original contract with Peat Marwick. These activities included:
 - Strengthening auditing. Original plans for the development of audit manuals, procedures, and training had not been fully completed. This was also the case regarding field and office audits of taxpayers under the VAT and income taxes.
 - A VAT pilot auditing program was then in progress. It should be completed and the regular auditing functions for the VAT modified accordingly.
 - in the area of customs, an automated vehicle clearing system had been created, but was not installed at all customs offices. Installation should proceed. Also, a plan for tracking goods in transit from Santo Tomás to Guatemala City, should proceed.
 - the COBRANZA model should be developed as a tool to better manage audit procedures.

- Assuming that a new tax reform law would soon pass, (which it did) its features would have to be incorporated into a relevant set of new rules and regulations. This activity should be considered a natural extension of the assistance that the FAP team provided to the Ministry in the design of the tax package.
 - Steps already begun toward upgrading the computerization at the Ministry should be completed. This should include appropriate training.
2. Initiate activities that have high priority, and which promise significant benefits *if* GOG and Ministry commitment is forthcoming. It was recommended that these activities should not be planned to extend beyond June, 1993. This option was only available with a commitment by AID of a significant amount of new money and required significant and almost immediate commitments from the GOG and the Ministry. Work should not extend into totally new areas. Since many of the tools that the project had developed were not in use, there was no need to develop new tools. Since the quality of tax administration performance was very poor, a project extension should be aimed at providing the basics. Thus, all activities recommended, focussed narrowly on collections, auditing and data processing. Furthermore, while all areas of tax administration in Guatemala are deficient, some taxes are more important than others with respect to their revenue yield and/or their impact on economic efficiency and equity. Therefore, any extension should focus more narrowly than the original project on:
- income tax reform
 - VAT administration
 - customs
 - computerization.

The creation of a fiscal analysis unit in the MOF was one of the unmet objectives of the original project. The original project provided most of the non-personnel raw materials (models, data, computerization, analytical studies) needed for the creation of such a unit. The cost of this infrastructural development was \$2-3 million, and without the establishment of a permanent fiscal analysis unit most of this would be lost. Furthermore, the creation of a fiscal analysis unit remained a good idea, but it would require Ministry action. Without a serious effort to form a fiscal analysis unit, extending the FAP for 18 months could be a wasted effort. Thus it was recommended that the Ministry create the fiscal analysis unit and specify the role that it would play in the Ministry. The MOF would also be required to appoint a director who is capable of running the unit, and who is directly answerable to the Minister, recruit a professional staff, agree to provide salaries that are adequate to attract, maintain, and motivate them, and provide office space, supplies, and equipment.

III. THE (FAP) EXTENSION, JANUARY-JUNE, 1992

A. Scope

The original FAP was scheduled to terminate in January, 1992, but was given a "no cost" extension ending June 30, 1992. No new terms of reference were issued for the extension. Therefore, to evaluate activities in this period we will use the same criteria as were applied in Section 2 above. However, one modification applies. When the original FAP was evaluated in December, 1991, recommendations were made that the FAP proceed in a limited manner. No new activities should be started and only those with high probability of pay-off should be continued. Activities should focus on income tax, VAT and customs, as well as on the installation of already-begun computer applications. Also, a fiscal analysis unit should be created. Thus, in evaluating the project during this period we will use the original terms of reference as a point of departure, but interpret them in light of the December recommendations.

1. *Development of Analytic Infrastructure and Models*

One of the main features of the original terms of reference was assistance in fiscal policy and tax design. By the end of 1991, with FAP assistance, new tax legislation had been designed, and submitted to Congress. Therefore no new design work was required. During the January - June, 1992 period the tax laws were passed by the Congress and signed into law by the President in May. Thus, the work of the FAP advisors shifted to development of the regulations and other tools that would make application and administration of the new law practical. Indeed, most of the time of the resident advisors was occupied by this activity during the period and we will mention this again as we deal with more specific subjects.

The second activity under this heading relates to the development of microsimulation (and other) models. Most of the originally proposed models were either completed or near completion by the end of 1991. These have been mentioned in Section 2. During the period in question work on model development was completed. Still, given the Ministry's ability to run, update and use formal models, there were probably more models than could be used.

2. *Specific Analyses*

Since the new tax laws were already there was no need for additional analyses of tax design issues. No new technical memoranda appeared during this period.

3. *Operations and Administration*

The new tax laws covering the VAT, income tax (and others) were signed into law by the President in May, 1992. During the January-June period the FAP team became increasingly more involved in first refining the language in the law and then designing implementing regulations. Indeed, from about April until the laws went into effect in July, this was the FAP

team's main activity. The Minister of Finance continued to rely upon FAP team members for this function, for lack of competency in this area within the Ministry's regular staff.

Income Tax Administration. Activities related to assistance in administering the income tax included the following:

1. Execution and refinement of a computerized tracking system for audit-generated tax deficiencies. During the extension of the FAP, the name of this model was changed from the COBRANZA to "files control program." Basically the program covers every stage of an audit, from the issuance of a tax audit order until the solution of final appeal. This model was installed in the income tax and VAT units and in all the other MOF units related to the appeals process. The model is capable of controls on the early stages of audits, most importantly, the selection of cases to be audited. The program can control the time expended by auditors in each case and can create a file of taxpayers with tax delinquencies. While the program is capable of these functions, audit personnel were slow to use the model's capabilities.
2. Development and execution of improved processing procedures for the reconciliation of bank receipts. In about May, 1992, it was discovered that the system designed by BID/CIAT, for tax collections through the commercial banking system (the so called "sistema bancario") was not working and its development was far behind expectations. Furthermore, BID/CIAT was preparing to wind down their operation in Guatemala. The FAP took over the development of the system. This work was to occupy the FAP for the next year.
3. Development of an organizational restructuring plan for the DGRI. This had been an ongoing activity from the beginning of the FAP.
4. Development and execution of selected audit programs and audit technique seminars.

Activities which were planned originally but which were either partially accomplished or not undertaken at all include:

1. execution of a more functional structural organization for the Internal Revenue Directorate;
2. simplification and expedition of the taxpayer registration process;
3. establishment of one MOF unit responsible for non-filer and stop-filer identification;
4. establishment of a Collections Department with responsibility for contacting taxpayers in arrears;
5. institutionalization of training functions in the Internal Revenue Directorate;

6. development of a comprehensive auditor training program and evaluation standards for audits.

Failure to proceed in these areas was largely a matter of priorities. The fact that the new tax laws were scheduled for implementation on July 1, lent urgency to the production of regulations and most of the resident advisors' time was spent on this. The fact that a crisis was developing with the sistema bancario diverted further attention from the original goals. It was not contemplated in the original terms of reference that either of these two activities would occupy as much time as they did. Finally, action in these areas required that steps be taken by the MOF, not by the FAP team. The FAP team can only advise and present plans; it cannot act on these issues unilaterally.

Administration of Domestic Indirect Taxes: As before, the operational focus of the FAP during this period was almost exclusively on the VAT. As before, the long-term advisor on VAT administration and operations was to be responsible for aiding the MOF in making day-to-day VAT operational improvements, to interact with others regarding computerization and auditing techniques, and to lead in-country VAT training programs. Most important during this period was to work on the implementing regulations for the new VAT law going into effect on July 1. Some formal training was done, most having to do with the new law and its implementation

Customs Administration: Work in customs had gotten off to a slow start in the first two years of the project as the director of customs at that time did not welcome outside "interference". However, under a new director work was begun and some progress was made. In the area of customs administration the FAP's activities were intended to improve the capability of administering customs duties, while adapting to the Central American Unified Rates ... 5% minimum and 20% maximum ... in November 1992. Most of FAP activities consisted of the development of the computerization of customs operations.

Activities in this period included:

- extension of the vehicles assessment system--SISAFUA--to three customs locations ... Santo Tomas de Castilla, El Carmen and Puerto Quetzal;
- planning for a computer center within the DGA;
- improvement of SIDUNEA-SISAFUA communications. Due to the need to integrate information on the VAT collected via imports with DGRI systems, it was decided to keep the SIDUNEA system as the base for the computerization of customs and to add computerized routines for managing the information obtained from it;
- creation of a program of rotation of customs officials.
- Development of the pilot program to strengthen merchandise transit controls;

Unfortunately, much of what was done by the FAP team in customs was done without much integration with customs. Team members became involved in day-to-day customs administration, and ended up doing work that should have been done by regular customs officials. Without the input of the team members on all dimensions of customs modernization, it is not clear that anything would have been done. Compared to other FAP activities, there was much less responsibility for change placed on the customs staff and more on the FAP team.

Budgeting and Expenditure Management: The evaluation done in December 1991, noted very limited progress on carrying out the objectives of this activity. Furthermore, the evaluation recommendation for extending the project did not include continued work in this area. Nevertheless, two advisors continued to work in the area and continued to have very limited success. The advisors continued to be drawn into day-to-day budgeting work which left little time for other activities. Furthermore, much of that work was with the other public agencies outside the MOF which must be involved in budget preparation, including the Congress. The fact that these other groups must be included in the budget process dissipated the teams activities among too many outside demands. Training was sporadic and informal. Little was institutionalized within the DTP. A Budget Analysis Unit was not created nor did the MOF provide support for its creation. According to the contractor, this occurred because the MOF did not appoint a counterpart for the task. A multi-year budgeting framework was not developed because it requires coordination of current and capital spending plans between the MOF and other agencies, which never came about.

Computerization: During this period the FAP team continued the decentralization of data processing using a microcomputer network solution. The Ministry began to acquire the equipment needed and this, combined with FAP resources, were sufficient to speed the process. The resident FAP computer system advisor conducted a great number of training exercises, both on-the-job and in a formal setting. In addition the resident advisor was deeply involved in preparing for the new tax laws' implementation. A considerable amount of his time was wasted on developing systems (insisted on by the Minister) for payment by, and rebates to, exempt organizations. Later, the Supreme Court overturned the requirement that these organizations pay at all. The FAP had recommended all along that the exempt organizations simply be excluded from payment. It is not possible to list all of the ways that the resident advisor on computer systems assisted the Ministry. They are too numerous, too varied, and often occurred under "emergency" conditions.

Summary: The project's major contributions to the MOF's operations and administration may be summarized as:

- Computerization of the MOF via a microcomputer solution;
- Design the implementation of the tax reform legislation.
- Design and write implementing regulations for the new tax laws.

- Continue with training MOF personnel.

FAP advisors played a role normally carried out by regular ministry staff. The FAP resident advisor staff was constantly caught up in carrying out many of the short-run policy requirements of the Minister and upper-level MOF personnel. However, unlike during the first two years of the FAP, the MOF began to offer considerable support to the program. A fiscal analysis unit was formed (see below), monies were appropriated for computer equipment and for special contract employees with the technical skills necessary to carry out FAP objectives. Also, better personal support for FAP objectives were demonstrated by both the Minister and the Vice Minister under whom the project functioned.

4. *Development of an Institute for Fiscal Analysis*

The original project paper called for the formation of an institute for fiscal analysis. The project paper considered it one of the "most important long-term objectives of all project activities--sustainability." The evaluation done in December 1991, recommended that the unit be established as a precondition for extending the project.

On April 22, 1992, the Minister created the Dirección de Análisis Fiscal (DAF). Its purpose is to serve the analytical needs of the Ministry, and particularly the Minister, on matters of fiscal policy. The FAP had already been developing the analytical models to be used by the DAF and that work proceeded along with the training for the new staff. By the end of the period in question (June, 1992) it was still too soon to tell how the DAF would perform.

B. PROJECT PROGRESS, January-June 1992

During the "no-cost" project extension occurring in the first half of 1992, the project continued those projects already begun in its first two years. However, there was a change in emphasis. Since design of the tax modernization plan had been completed and new tax laws submitted to the Congress, there was need to refine the draft laws to suit Guatemalan conditions and politically determined constraints. The major laws, modifying the income taxes and the VAT, were passed by the Congress in the spring of 1992, and signed into law by the President in May. They went into effect on July 1, 1992. Once the laws were passed, implementing regulations were required, procedures designed to administer them and DGRI staff prepared to carry out the implementation. This almost full-time task was the main work of the FAP resident advisors during the period. In general, during the period, the FAP carried out the recommendations made at the end of 1991. The DAF was created, the team continued work already under way, the project was not extended into new areas and assistance was provided for the implementation stage of the new tax laws.

IV. THE MAIN FAP EXTENSION (July 1992 - December 1993)

The objective of this section is to examine and evaluate the FAP over the period of the contract extension. Originally the extension was for the period July 1, 1992 through October 31, 1993. Subsequently there was an additional "no-cost" extension through December 1993. The methodology for developing this evaluation is as follows:

1. We will examine the terms of reference for the extension in a somewhat mechanical manner, to determine if the Peat Marwick team complied with expectations.
2. We will identify those areas where activities of the FAP team differed from the terms of reference. In some cases the team may have gone beyond the terms of reference or they may have fallen short. In either case we will make a judgement about the reasonableness of deviations from the work plan. It is here that political or bureaucratic constraints on the team will be assessed.
3. We will identify the major problems remaining after the extension and how these affected the outcome of the project overall.

The terms of reference for the extension called for work in eight areas which we will examine in turn. These are:

1. Policy analysis
2. Income tax administration
3. VAT administration
4. Customs administration
5. Budgeting
6. Organization and Management
7. Computerization and information systems
8. Training

A. Policy Analysis

Activities in policy analysis fell in two categories. First, the FAP team was to assist in the development of the Dirección de Análisis Fiscal. Second, activities were supposed to contribute to the Ministry's abilities in policy analysis.

1. *The Dirección de Análisis Fiscal (DAF)*

The Dirección de Análisis Fiscal was established in April 1992, and currently has a staff of 12. Its main mission is to help the Minister make decisions by analysing the performance of budgets and fiscal performance, but most of their work has emphasized the performance of public revenues. Models are run to project revenue for up to 2 years with the current tax structure, with changes in the tax structure and/or changes in the macro-economic environment. To ensure that FAP projections are consistent with other projections made for the Guatemalan economy,

the FAP uses the macro-economic figures and projections of the Banco de Guatemala as part of the basis for its work. The Banco de Guatemala also produces revenue forecasts, against which FAP checks its own. In fact there is little difference between them, and differences that exist are apparently due to differences in assumptions; not due to differences in models or data.

2. *Technical Assistance in Policy Analysis*

The FAP team has worked with the DAF to install models that had been developed during earlier phases of the project. Models now available to the DAF are:

- Revenue projections for the personal income tax,
- Revenue model for the business income tax.
- Revenue model for the indirect taxes: VAT on imports, VAT on domestic consumption, customs duties.
- Overall tax collection model which collects the output from the above three models, and adds taxes from assumptions about miscellaneous taxes not included in the above three.
- A budget monitoring and forecasting model.
- A general equilibrium model.

The general equilibrium model does not have a well established and up-to-date data base, and does not now, and probably will not play much of a role in policy analysis in Guatemala⁵. However, the other models are used frequently to produce comparisons of planned and realized revenue and expenditure comparisons and forecasts. These forecasts are used primarily by the Minister of Finance. DAF staff have received considerable training from the FAP in the use and maintenance of the models and technical memoranda have been produced on each of the models, along with detailed users manuals for each model. Of the full set of technical memoranda produced by the FAP, those numbered 24 and up were produced during this phase of the project, and all of them were done to serve the interests of the DAF. Data bases of all models are not entirely up-to-date, but DAF staff are currently engaged in data up-dates.

3. *Comments*

While these models are useful, there is a danger in overreliance upon them. The models are not very sophisticated in the way they must be used in Guatemala. While the models are capable of

⁵ Under the conditions existing in Guatemala, with very poor data and analytical support, it was naive to think that a general equilibrium model would serve much purpose.

considerable analytical use, the data constraints on them limit the way they can be used. Some uses may amount to little more than summing the effect of a number of preconceived assumptions made by the user. The use of a model may give the appearance of sophisticated analysis when in fact the model simply covers up the fact that only a few unsubstantiated assumptions are being simulated.

Interviews with DAF staff, reveal this to be the case. Results from a modeling exercise that was prepared for the Minister were examined and discussed with the DAF staff in charge. The models automatically produce a number of tables and charts. The report on the results presented these tables as if they spoke for themselves. There was no analytical comment. Indeed, what was reported in the document was in some ways misleading, and DAF staff did not seem to appreciate the need for specifically identifying what the assumptions were that created the results, nor conducting an analytical discussion of the results.

Main problems for the DAF are:

- Analytical abilities and content of work seems limited. This was recognized by the FAP team (Monthly report March 1993) and special training has been conducted to try to raise these capabilities.
- Only the Minister receives, and presumably uses, information from the DAF. They do not seem to be integrated into any other activities at the MOF⁶.
- The professionalism of the work habits of at the DAF have been called into question. For example, The DAF reported to the FAP office that the models were "not working" (Monthly report, Feb. 1993). Upon investigation it was found that the data bases for the models had been erased and had to be reinstalled. On several other occasions, when DAF staff reported to the FAP that the models were not working, investigation showed that a computer virus had destroyed the models and they had to be reinstalled. Indeed, rather than using back-up programs, the FAP staff allowed the source programs to be destroyed by viruses⁷. This has happened more than once.
- The DAF is being tempted to take on more tasks than it should at this stage in its development. For example, it has been asked to identify pockets of poverty which will be candidates for new anti-poverty expenditures. This is something that the DAF has not been trained for and would probably be best done by the Planning Ministry. Also, DAF has been working with SIECA and the Central American Economics Ministers on international trade issues. Again this is something outside their original scope. Spreading the DAF too thinly may jeopardize development of the skills that were originally

⁶ This is probably acceptable, since the DAF's main function is to serve the Minister.

⁷ FAP staff reports that the DAF staff frequently trade programs with friends and acquaintances and that this is the source of the virus problem.

intended to reside at the DAF.

The DAF is still a young organization and some time must be allowed for its development. The FAP has scheduled two additional courses for the DAF on international trade issues (late November) and macro-economic analysis (December). However, it is not clear that once the FAP ends, the DAF will be a self-sustaining, developing institution.

B. Income Tax Administration

By far the main contribution of the FAP advisors was in assistance on the implementation of the new income tax laws. Regulations were designed and written and eventually decreed by the Minister. This work involved the FAP advisors in the day-to-day operations of the Ministry. In addition the FAP advisors drafted documents used by Ministry counterparts to make information presentations to the Guatemalan private sector on the new laws. Without the help of the FAP advisors, implementation of the new tax laws would have been very difficult due to the lack of training and experience among regular MOF employees in conceptual and technical matters.

1. Specific measures

The FAP terms of reference listed several specific areas of assistance. These are:

Administrative reform: Throughout the course of the FAP, its resident advisors worked on administrative reform, particularly within the DGRI. Reform plans were designed, presented and discussed with the Minister and Vice Ministers. The FAP continually recommended reorganization along functional lines, but little or no interest was ever shown by the MOF. Reorganization of DGRI occurred in early 1993, but it had no relationship to FAP recommendations. FAP staff were simply notified that reorganization was to occur. The reorganization was described by one FAP resident advisor as "disfunctional". While the Ministry has shown little interest in the FAP-recommended overall organizational changes, the FAP has probably had some influence. For example, the DGRI is currently reorganizing the Sub-Dirección de Fiscalización to contain a department of audit which will eventually unify audits of the income tax and VAT. Furthermore the Departamento de Informática reflects FAP influence.

Training and personnel development: The FAP contributed greatly to personnel development at the DGRI. Training exercises were mostly on-the-job. Working one-on-one with FAP advisors, most professional staff, in key units (Informática, DAF, auditing), are former FAP employees and trainees. Where less progress was made was in permanently changing the personnel system of the DGRI. Personnel development plans were recommended, but the MOF was not able to permanently change the system. Rather, the response was to hire qualified people under special contracts to compete with the private sector. This is not a permanent solution to the Ministry's personnel problems.

2. *Comments*

It is difficult to separate assistance in Income Tax administration *per se* from assistance offered in operations and administration. Most of the needs of the income tax administration is in the area of auditing. This is dealt with below.

C. VAT Administration

As was the case with the Income Tax, the FAP VAT advisor worked on the day-to-day implementation of the new VAT law and played an indispensable role in that process.

1. *Specific measures*

Organizational reform: After the passage of the new VAT law and creation of implementing regulations, the VAT resident advisor did a full diagnostic of the organizational and personnel needs of the VAT Department. Most sections within the department were very deficient in carrying out the functions required by the VAT. For example, the "Analysis" section is supposed to review and resolve cases found deficient by auditing. An inventory of their work showed no document control, much duplicated effort, time spent on unimportant cases involving trivial sums of money. The section was years behind in its work. Other sections showed similar traits. In the case of the analysis section the advisor developed a work plan and a method for choosing important cases. Similar recommendations were made for other sections.

Reorganization of the VAT Department was recommended, but, along with the Minister it was decided to establish a special "Programa IVA" (or sometimes called "Comisión IVA) to design and implement a reorganization. With the FAP advisor, the Programa IVA has designed a number of computerized modules to handle important work functions such as:

- authorization of documents, books, cash registers,
- control monthly VAT filings,
- detection of filing errors,
- produce full information by VAT payer
- identification of non-filers and stop-filers,
- and many other functions necessary for VAT administration.

The Programa IVA is currently developing these methods. It is also working on a reorganization of the Sub-Dirección de Fiscalización to put these tools to work. The reorganization plan for that division includes functions in studies, planning, programming, selection of taxpayers for audit,

audit execution and evaluation of results.

Training on VAT law, regulations, accounting and audit. The main tool for training has become the Programa IVA. Personnel in that program have been trained by the FAP, and their objective is to create a functioning, modern VAT administration.

Taxpayer control, including updating taxpayer registry. Taxpayer control and updating of taxpayer registries has been a somewhat frustrating exercise for the FAP. All the analytical tools and training necessary to perform these functions have been provided. However, monthly reports indicate continual frustration with follow-up in the VAT Department. When FAP staff insist that these measures be taken, and assist with them, things get done. When these functions are left to the VAT staff little progress is made. Nevertheless the system, as designed, is capable of making taxpayer control and registration very efficient. It is now possible to obtain a taxpayer's NIT instantly. The process is fully computerized and has been decentralized to all major tax administrations in the country (through cooperation between the FAP and the UNDP project on decentralization).

Audits. Auditing of the VAT is very deficient and is perhaps the largest single factor constraining increases in tax revenues. More will be said about auditing below.

2. *Measures not originally in terms of reference*

Development of the "Sistema Bancario" was probably the most important task related primarily to the VAT that was not mentioned in the terms of reference. This activity is described below under O&A.

3. *Comments*

The weak link in administration of the VAT is in auditing. While the FAP has provided all the tools and training that should be necessary to effectively audit the VAT, the tools are used weakly. Monthly FAP reports reveal continual frustration with the DGRI's inability to conduct effective audits. Persistent problems include:

- Audits have no planned strategy.
- There is no focus on large taxpayers, nor on holding companies⁸.

⁸ To illustrate the possible pay-off from auditing large VAT taxpayers, consider the concentration of economic power in Guatemala. In April 1993, the FAP VAT advisor did a study of VAT returns for the month. There were 35,373 normal VAT returns filed that month, but only 64 of them paid Q25.3 million, of the Q55.4 million paid. These 64 paid 45.6% of all VAT paid in the month. Six of those 64 paid Q11.3 million, or over 20% of

- Technical capabilities for cross checking and development of an audit plan are not used.
- Data bases are not kept up-to-date. (eg. taxpayer registry, input from the sistema bancario).
- Procedures are complex and duplicative. Audits never seem to end.
- There is no routine analysis of what the pay-off from audits has been, nor of what is expected from on-going audits.⁹

Particular problems result from a failure to follow up on audit-related activities and inattention to details. Some examples of non-follow-up include:

- Auditors resist the idea of accounting for the time spent in audits. Without this information it is difficult to develop a realistic audit plan.¹⁰
- The file control system is not updated unless FAP staff insist and assist.
- Timely files transfer among sections is not done.
- Trivial problems are allowed to become large ones. For example, on many occasions, the FAP requested space for the IVA Department to put VAT files that were being processed. No space has yet been forthcoming despite perpetual promises.
- VAT auditors are still working on cases from the old VAT law¹¹ and are making little progress despite adequate personnel for the job.

the total.

⁹ This is despite the efforts of the resident VAT advisor and the work of the FAP consultant (Mr. Beytia). With the consultant a special effort was made to develop VAT audits and the pay-off from them was analysed and demonstrated. No follow-up has been forthcoming.

¹⁰ The document control system devised by the FAP is capable of recording this information, but auditors do not supply it.

¹¹ VAT credits existing on June 31, 1992, could not be carried over into the period covered by the new VAT law. A special VAT audit was necessary to close out 96 unresolved cases claiming credits as of that date. The resident VAT advisor has continually prodded auditors to finish those cases and to move on to administering the new law. But little progress seems to be made despite having 22 auditors assigned to the 96 cases. When the FAP VAT advisor does not push this issue, no progress is made. During suspension of AID activities in May-June, 1993, nothing was done on the pending 96 VAT cases.

In addition to these problems people who administer the VAT are faced with several insitiutional problems that make their work more difficult.

- Fines for VAT non-compliance are very low, (a maximum of Q1.000). Some taxpayers prefer to pay the fine rather than comply.
- Procedures for demanding supporting information from taxpayers are very complicated and favor the taxpayer.
- Constitutional guarantees of bank secrecy prevent auditors from obtaining any information that may be available in bank accounts.
- Presumptive tax liability has been held to be unconstitutional.
- Appeals made by taxpayers, against official assessments, and the imposition of penalties, are not under the control of DGRI. Thus, DGRI lacks the power to follow through on its decisions.

Finally, in the opinion of the resident VAT advisor, the main problem reduces to the poor quality of audit personnel. Auditors in the VAT Department have frequently not finished their training in accounting before becoming auditors and some have been promoted to auditing from jobs requiring no accounting skills. Some auditors are former secretaries with no accounting backgrounds. The FAP advisor believes that this lack of professionalism is particularly acute in mid-level management such as among heads and sub-heads of departments, section heads and supervisors.

D. Customs Administration

Customs was one of the areas where the least institutionalization of FAP-inspired measures occurred in the first two years of the project. During that period there was very little cooperation, and some hostility, from the DGA. During the FAP extension, DGA became more receptive. Nevertheless, FAP advisors worked almost alone on steps to improve customs administration.

1. *Specific measures*

The terms of reference stated a number of very specific activities to be done by the FAP team. We deal with each in turn.

Finalize implementation of Santo Tomas Merchandize In Transit Pilot Plan and extend the plan to all customs administrations: This activity occurred via the development of specialized software installed in two of the twenty customs administration locations, and the regulation of daily reports via fax or mail from another twelve customs administrations that have no other facilities for communication.

Develop automated system for the control of merchandize in transit: This activity resulted in the SICOTRANS program which provides information on the movement of merchandize in transit through Gatemalan territory--around 5,500 transactions a month. The system has experienced control failures. Around 50% of merchandize in transit never is registered as arriving at its destination. In other cases delays of up to twenty-five days have been reported for the arrival of goods to points that are no more than five hours away from the port of entry.

The SICOTRANS program contains:

- Guides to local consignatories and guides for international transit.
- Accounting for deliveries and report of arrivals.
- Controls on movement of merchandize in and out of private deposit and storage facilities.
- Controls on movement of merchandize in transit through Guatemala to other countries.

An important component of a program to control merchandize in transit is the rehabilitation of the container's terrestrial terminal of Guatemala City. The authorities took no steps on this measure.

There are several reasons why the program works poorly. Customs officials frequently allow non-registered customs agents to clear goods in transit. When the goods become "lost" there is no way of finding the agent. Also no steps are taken to find "lost" goods. Customs can generate a list of those shipments that are unaccounted for, but takes no steps to find the shipments. Finally, attention to the details that would provide adequate control are lax¹².

Extend the automated vehicle clearing system to all customs and coordinate its functions with the SIDUNEA system: The system of clearing vehicles is now working with the SIDUNEA 2.5 version in the main customs administrations where equipment is available. The vehicle clearing system has also been linked with the system of vehicle registration.

There have been difficulties with the vehicles entry program in establishing the value of vehicles entering the country. The MOF has failed to appropriate the money for the so called "blue book" and "red book" subscriptions that would provide up-to-date information on vehicle values. These books have been purchased by the the FAP staff, but no permanent arrangement for their acquisition has been made. Annual cost for these books is about \$300 per year. Detecting one undervalued vehicle could more than pay for this amount in increased customs duties. Failure

¹² For example, one of the FAP advisors pointed out to DGA officials that the seals used to control truck shipments were of such poor quality that they could easily be opened and replaced without customs knowing the difference. The official in question responded that indeed, the seals were of poor quality, but they were very cheap. So cheap in fact that DGA had ordered an additional 12,000 units.

to subscribe to these sources is an extreme example of either inattention to detail and/or false economy. Vehicles imported into Guatemala currently account for about 15% of all customs duties collected.

Link the SIDUNEA project with the value's database: Currently, the only working values database in the DGA is the one used in the automated vehicle clearing system mentioned above. The SIDUNEA is capable of linking to a values database if one existed. The FAP is currently developing databases for chemicals, textiles, raw materials, and basic grains, and it is expected that they will be finished within the term of the project and be compatible with the SIDUNEA project.

Unfortunately, the DAG has no infrastructure to deal with value data bases. Unless the MOF commits to the maintenance of values databases they will become quickly out-of-date. Failure of the Ministry to subscribe to the vehicles blue book is minor compared to the information needed to keep up on the values of other items. It is likely that subscription to a valuation service will be required. Without this, links to a value base are not very useful.

Assist in the implementation of the existing plan for an organizational restructuring of Customs: The FAP has gone beyond simple assistance and has prepared the plan as requested of the authorities. However, there is opposition to the plan, mainly coming from the 6 powerful labor unions within the MOF. Also the authorities are thinking in a deeper privatization of the customs service, and that has delayed any decisions on this issue.

Further privatization of storage facilities is possible although this service is already mostly in private sector hands. Privatization of verification of merchandise in the port of delivery is possible although prior experience with international firms show that this is subject to the same problems that occur in the verification of point of arrival: delays, losses of merchandise, and corruption. An important consideration in the privatization of customs services is the commission that international firms usually charge for this service ... around 5% of FOB prices, and the condition that a large percentage of imports be under their control. Currently the only Latin American country using services of this type is Peru, and no great success there has been documented up to the moment.

Develop a comprehensive and permanent Customs training program: The FAP prepared a project for the creation of a Customs School. This proposal is based in the scarcity of university programs in the area in Guatemala. Some senior personnel of the DGA were trained abroad but in most cases this occurred years ago. An alternative is for the Government to contract the training with private universities but this option has not been pursued. The decision to create a customs school would require a decision to modify the organic structure of the DGA and decisions to do so seem to be awaiting decisions on the role of privatization in customs.

Assist in the development of an internal audit office and in the establishment of permanent audit programs: The FAP has prepared computerized programs that constantly produce reports for accountability on DGA operations. These include:

- System of control and management of collection (SIGEREC).
- System of rotation and information of personnel (SIROPE).
- System of mail control (SICROCO)
- System of control of DGA's inventories (SASADM-IF).
- System of control and productivity of data filing. (SISCOPE)
- System of control of treasury (SISADM)

Also the FAP advisors have prepared a comprehensive proposal for organization of an internal audit office, which has been in the hands of the MOF and DGA heads since June 1993.

Expand and monitor the program for control of customs agents: Information on all customs agents is managed in a centralized way, and is available in most customs agencies. In addition an ex-post control is regularly executed to detect customs agents operating without a licence. This program controls (a) the agents and (b) their authorized dependents, ("tramitadores"). It is possible to cross check with the NIT data base and allows the consolidation of the number and value of customs transactions handled by agent and by importer.

2. *Comments*

In contrast with the relative high degree of institutionalized accomplished by FAP in the DGRI, the Customs Directorate -- DGA -- has not paid enough attention to the FAP contributions in customs administration. FAP resident advisors have been more involved in day-to-day activities of the DGA than has been the case in other activities. Counterparts in DGA have not been forthcoming, though the support of DGA headquarters has improved since the beginning of 1992.

While changes in computerization of the DGRI represented significant improvements in efficiency, similar benefits are not so clear in the DGA. Most of the computational improvements in the DGA, through mid-1992, were from the UNCTAD project, SIDUNEA. When that project ended in June 1992, it left the system working in seven Customs agencies but the MOF was apparently not aware of the need to provide budgetary support to this activity. The SIDUNEA system stagnated. The FAP experts have advocated computerization in the DGI and the impact it could have on improved collection of customs duties and VAT.

A regular and permanent computer unit in the DGA has not been created. Rather, a provisional unit grapples with the demanding requirements of the DGA, but with minimal infrastructure. Budgetary support for the maintenance of equipment and regularization of the status of computer specialists is the weakest part of the DGA system.

Because of DGA's weakness in computerization, FAP experts in Customs have been very active in continuing the development of the SIDUNEA. They have created software that makes it possible to use the database provided by SIDUNEA, and others that were not included in the terms of reference. Other data bases created by the FAP experts included SIRETRA, which controls transporters, and SISACOMP, controlling temporary imports. They are also currently developing a program called SISAFORM, which automates expedition of customs forms, SICOMAQ, which controls in-bond processing firms, and SISHW, controlling computers within

the DGA.

E. Budgeting

1. *Specific measures*

FAP assistance to the Dirección Técnica de Presupuesto (DTP) after July, 1992 was very limited. Resident advisors worked on the project only through September and their work was limited to finishing some activities began in early 1992. Advisors worked primarily on the development of the budget, and were involved with many parties other than personnel of the DTP (as they had in earlier periods). Most of the training conducted was somewhat informal, consisting of seminars, short courses and discussion with relevant parties. A course was conducted on analysing the fiscal implications of budgets. Documents were prepared to support this interaction on subjects such as:

- A guide for formulating budgets for decentralized agencies,
- Elements of budgetary planning and programming,
- Basic concepts of the public budget,
- A course on programming and analysis of the budget.

2. *Comments*

FAP assistance on budgeting was mostly occupied with day-to-day involvement in budget preparation. Perhaps three-quarters of the advisors' time was spent in this way. While some progress was made in budget presentation, it is not clear that the FAP has had a lasting impact on the DTP. Current DTP training does not appear to have been influenced much by the FAP. No significant reorganization of the DTP has occurred. A unit to evaluate budgets was suggested and designed by the budget advisors, but no steps have yet been taken to form such a unit.

Failure of the FAP in having a permanent impact on the DTP is probably due to a fault in the original FAP design rather than to and FAP activities. Budgeting is such a large and multidimensional problem that it was naive to think that tacking on a budget component, to a project focussed mainly on taxation, would have any significant impact. Project designers should have realized that taxation and budgeting are two functionally separate activities each important unto itself. By treating budgeting as a relatively minor addition to a tax project set the activity up for limited success from the beginning.

F. Organization and Management

Often it is not possible to separate activities in "organization and management" from those aimed at the administration of the VAT and Income tax. Nevertheless, the terms of reference made a distinction and we will attempt to do so as well.

1. Specific measures

Assist in implementing the Tax Modernization Program: One of the main activities of the FAP team has been assisting the MOF in the implementation of the tax modernization program. Indeed, on some occasions one could say that they were occupied 100% in this activity, especially in mid-1992. Almost everything mentioned here is in some way related to that program.

Recommend restructuring of DGRI: Throughout the course of the FAP, its resident advisors worked on administrative reform, particularly within the DGRI. Reform plans were designed, presented and discussed with the Minister and Vice Ministers. The FAP continually recommended reorganization along functional lines. Reorganization of DGRI occurred in early 1993, but it had no relationship to FAP recommendations. FAP staff were simply notified that reorganization was to occur. The reorganization was described by one FAP resident advisor as "disfunctional".

Assist in monitoring new administrative activities: The FAP team developed a implementation plan for all levels of tax, customs and budget administration. Then, working with the Organization and Methods Department, the FAP team assisted in the the development of operations manuals for the DGRI. As of ~~the~~ writing, the O&M Department has produced more than half of the manuals required (the higher priority ones) and has a active plan to produce the remainder by 1994. Organizational restructuring plans for the DGRI were developed as well as for the Audit Department. Rules and regulations for both the new VAT and Income Tax were designed.

Assist in developing work-flow, staffing needs, systems and organizational structure: Some of the main activities and accomplishments of the FAP team include:

- Development of specific audit and collections enforcements programs,
- Development of an audit plan in 12 specific non-compliant VAT and income tax areas,
- Staff for key positions were trained and placed within the Ministry. Often this took the form of FAP employees learning on-the-job, but then receiving FAP support as

candidates for permanent MOF positions.

Assist in the development of personnel: Training has always been one of the key ingredients in the FAP program. Furthermore, the FAP assisted the DGRI in particular with determining proper staffing patterns. Of particular concern is the quality of auditors. Most training has been oriented around auditing, and one could build the case that the computerization that has occurred also has auditing as its main objective. Thus, in auditing (and in computer systems) the FAP has been particularly active in attempting to leave behind an internal training capacity. Now (late 1993) audit trainers have been established in the audit department, training materials have been developed, and the first audit training activities have taken place. However, on the Ministerial level no special training unit has been organized.

2. *Measures not originally in terms of reference:*

The FAP made a very significant contribution to DGRI in two areas that were not anticipated in the terms of reference. *First*, the project developed a system for registering and taxing motor vehicles¹³. *Second*, the "sistema bancario" for collecting taxes at commercial banks was completed.

Prior to 1993, the system for registering motor vehicles was done on the Ministry's mainframe computer. There were several problems with this.

- The system was so cumbersome that registration could take up to two months.
- All other DGRI functions had been moved to open systems on PCs. For consistency this function too should be on PCs.
- The existing system was a source of petty corruption. There existed no audit system. Anyone could enter the system and change records, facilitating the registration of stolen vehicles or those that had entered the country without paying proper customs duties.
- The vehicle data base on vehicle ownership was deteriorating.

Beginning in late 1992 a plan was devised to transfer vehicle registration to PCs. A program for this had already been written by a DGRI staff member in the Departamento de Informática, with design help from the FAP staff. The FAP resident computer advisor (Westrick) did the data transfer from the mainframe, and wrote programs to link it with customs. Now, the only source of new vehicles is through imports (except for motorcycles). This combined with a cross checking and security system make it very difficult for stolen vehicles to be registered. Now,

¹³ Registration of motor vehicles should probably not be a function of the MOF. It is more properly a function of the police or Ministry of Hacienda.

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vehicle registration occurs in as little as one hour.

Installation of the vehicles system was not without frustration. At first, personnel in the Vehicles Department obstructed adaption of the system, for the old system was a source of income for them. The department head did not forcefully push for change. As the system was put in place department workers found that they could create a source of income for themselves by slowing down the registration process (to perhaps two weeks); then offering to speed up the process for a fee. System changes were required to prevent this practice. In September 1993, a new department head who supported the FAP measures was hired and some other personnel changes occurred. Since then problems with the system have almost disappeared, and full transfer of the system from FAP to Vehicles Department control has been made.

The second area of unanticipated assistance by the FAP was in developing the "sistema bancario", through which commercial banks collect tax payments for a commission. Originally, BID/CIAT was involved in setting up the "sistema bancario", but BID/CIAT had done little, had not documented what they had done and were winding down their project in Guatemala. By mid-1992 a crisis had developed. There was no data control on tax returns flowing through the banks, no inventory of cases being cleared by the banks, and no procedures manuals. Recording tax returns was months behind, and taxes collected were not available for use for months.

The FAP O&M advisor (Coburn) took over the development of what BID/CIAT had been responsible for. Proper computerized procedures were developed, rules established and operations manuals produced. By late 1993 the "sistema bancario" was working well, with 146 commercial banks around the country accepting tax payments. Daily reconciliation of payments and associated documents can be made by the banks and monies are delivered to the MOF weekly. While the system is working well with the banks, MOF (at Control Tributario) still has a backlog of about 45 days in recording returns.

3. *Comments*

Operations and administrative assistance to the MOF is a rather open subject and not as subject to "quantitative" evaluation as other activities. The subject is not entirely separable from administering the VAT and Income taxes. Nevertheless, it is our judgement that the FAP was very responsive to the MOF's needs. As the project progressed, many ad hoc requests were made of the team, often by the Minister or Vice Minister, and which were normally met with quick and effective responses. The new tax laws which went into effect in July 1992, probably could not have been implemented without assistance from the FAP.

The FAP team recognizes that *improved auditing is the key to effective tax administration and is perhaps the weakest administrative function within the MOF*. On July 15, 1993 the FAP advisors presented an ambitious and detailed audit program to the Minister. The program would involve 96 auditors, 8 supervisors and others. The official response was much more modest, involving only 42 auditors and 6 supervisors. Most of this audit activity will be done by

contracted employees, working under the direction of the Programa IVA. Though the Minister's limited commitment seems to be official recognition that the normal audit functions within DGRI do not work, the "solution" seems to be only a temporary one. What is needed is a coordinated audit plan for both VAT and Income Tax together, and a permanent and qualified staff to carry it out.

The technical assistance provided by the FAP for control of tax evasion has been good. There is a program of tax audit that could profit from the current information related to evasion. However, the only manual on tax audit currently available was designed by the FAP. Both, the manual and the program, are well designed and appropriate to the level of capability of the personnel within the DGRI. But one must realize that the veteran personnel working in the DGRI have limited academic training and the new auditors hired by the agency have little experience in the management of tax audits for the public sector. Also, while technical assistance has provided a large amount of useful information, the inexperience of administrators in data management and use, creates new kinds of audit problems. Most administrators with whom the FAP team worked have not been those who are in direct contact with taxpayers. Those who are in contact with taxpayers may be unable to use the information available to design effective audits.

A notable feature of the model of tax audit developed by the DGRI, is that it is not based on audits of particularly large taxpayers. This is contrary to FAP advice. Rather the strategy is to take a general approach which looks for irregularities wherever they occur. Experience elsewhere would recommend the concentration of limited audit skills on those taxpayers from which most taxes are collected, rather than dissipating them across a vast sea of non-compliant small and medium-sized businesses. (Bird, 1992) Scarce administrative skill should be focussed on ensuring that the largest taxpayers comply fully with their fiscal obligations. In addition to being an object of audits by themselves, large taxpayer control yields important information on transactions with third parties related to them. As audit skills improve, it is important to then extend audits to smaller taxpayers. Failure to eventually extend audits to the medium and small taxpayers can eventually promote informalization of the economy or more sophisticated avoidance behaviors.

The strategy of tax audit created with FAP assistance, is based on using third party information - exporters, public sector, financial sector, etc. The DGRI has started with the collection of data from credit card sales and suppliers to the public sector to cross check against what is claimed on tax returns, especially as they pertain to the sales of services (restaurants, professional services etc.) This first step was somewhat disappointing because of the lack of standards in the filing of information by credit card companies and public agencies. Continued technical assistance may be necessary in the design of appropriate tax controls while the authorities gain expertise. Furthermore, additional controls for cross checking may be appropriate, such as using information from wholesalers, which may be organized better.

Tax audits are not now integrated. Audits of VAT, income tax and customs taxes now occur separately. However, plans are under way to integrate them and the computerized information systems promoted by the FAP will allow the integration once there is administrative resolve to

do so. An important element in the integration will be linking DGRI information with that of DGA.

An important aspect of the technical assistance provided by the FAP is in the selection of new audit personnel. The MOF has created an elite of auditors by hiring people with experience in taxation in the private sector. Around fifty new tax officers were incorporated into the staff of the DGRI, using personal service contracts to get around the limitations of the civil service. There is risk in this scheme in that these new auditors are not "permanent"; their salaries are not specified in the Guatemalan budget and these positions could be terminated by a decision of congress or of a new minister.

In spite of having hired additional audit personnel the coverage of DGRI audits is still low: less than 1% of the registered taxpayers are subject to tax audits. The risk of being caught for tax evasion remains low. The Ministry is attempting to make up for this deficiency by contracting for around ten thousand hours of private audit services, but this measure can only have limited impact for several reasons. *First*, private services are being paid for out of PL-480 funds on a one-time-only basis. After this private sector help is completed there is no source of continual funding. *Second*, if the private contractors uncover important cases of tax evasion, follow-up on those cases will undoubtedly extend beyond the period of the audit contract. Follow-up will then fall on the shoulders of regular DGRI auditors, whose follow-up on current cases is very weak. It is probably naive to think that the current arrangements with private auditors in Guatemala will yield significant results unless they are followed by significant upgrading of internal DGRI capabilities.

In response to the complexity created by the Tax Code, the FAP has designed software for controlling the transit of the results of tax audits (the COBRANZA program). After an audit is completed, but before payment can be demanded of the taxpayer, the documentation must go through a cumbersome series of steps on appeal. The FAP-designed software tracks the progress of paperwork through this appeals process. While the software is capable, it is not used to track cases before they leave the hands of the auditor and the issuance of an official assessment. What is needed is tracking of how and when cases are chosen for audit, to whom they are assigned, the status of information sought from the taxpayer, what decisions have been made about the case along the way, and all the other steps leading up to an auditor's final determination. The best opportunity for detecting tax evasion and mistakes occurs during these earlier stages of an audit. To use the tracking tool in this way would help auditing in a general sense and help in developing an audit strategy. If broad-based tax audits are to be used (as appears to be the MOF plan) then this sort of computerized assistance would be a great help.

G. Computerization and Information Systems

In evaluating what was done in the area of computerization and information system development it is difficult to separate activities into those occurring during the FAP extension and those before. Work in this area was continuous, and projects started near the beginning of the project

were developed throughout. The work was very consistent in that it developed a strategy early, then followed a plan for the project's duration.

1. *Specific measures*

While it is sometimes difficult to select specific measures for emphasis (as the words *computer system* would imply) there are some notable achievements in this area. These include:

- Development of a conversion program for transferring selected data to database formats and develop procedures for easy user access.
- Identify automation requirements for control of income taxes (business and personal) and VAT.
- UNIX was selected as the operational system and INFORMIX, with its tools, as the relational data base. These choices were conditioned upon the need to handle large volumes of data and to provide quick response in data handling.
- Modules (each of which may be composed of more than one model) were designed and implemented to permit rapid access, file handling, and data retrieval.
- The modules that were installed were set up to facilitate easy expansion and model improvement.
- Operating efficiency in the MOF was improved while creating a set of statistical information that is useful for policy analysis.
- Work was done jointly with people in the computer operations departments of DGRI, and DGA.
- Training was provided for all personnel involved in the operation and management of information systems. Most training was not in formal classroom settings. Rather, the FAP resident advisor worked one-on-one with each person. Only where introductions to the languages and tools were required was there anything resembling a classroom setting.

2. *Comments*

From beginning to end there was a planned consistency in the FAP contribution in computerization. The plan brought the project through the four stages of *first* the analysis of MOF needs and the system alternatives, including working on the existing mainframe and the move to open systems. *Second* there was a design stage where types of data and interactions

were considered to come up with solutions to MOF needs. This phase was pretty much complete by the time of the FAP extension. *Third*, programming occurred on the various system modules, in order of importance. *Fourth*, was the implementation phase where each module was installed, loaded with data, and tested. Personnel were trained simultaneously. All systems were then fully documented. The computer modules created by the FAP and their basic functions are:

- | | |
|--------------|--|
| 1. DTC | Provides data input. |
| 2. RTU | Controls tax identity numbers (NIT) |
| 3. PRD | Registers payment of VAT from 1983 to 1992. |
| 4. POLIZA | Centralizes accounting. |
| 5. PEAT | Controls VAT. |
| 6. MARWICK | Developments applications. |
| 7. DRH | Controls personnel. |
| 8. JURIDICA | Controls cases passing through the legal process. |
| 9. TREASURY | Controls documents |
| 10. CASHIERS | Controls the reception of payments |
| 11. BONDS | Accounts for bonds issued as part of the emergency bond issue, 1991. |
| 12. VEHICLE | Controls vehicle registration. |
| 13. ADUANAS | Control for aduanas. |

Each of these modules and the steps leading up to their creation were developed in a well detailed and documented way. Furthermore, this was done with the involvement of MOF personnel, which, by integrating them in the process, helps guarantee that capabilities remain after the project ends. The area of computerization and information system development is probably the area where the FAP has contributed most to the MOF.

H. Training

Most of the training offered by the FAP was not in a formal classroom setting. Rather, most occurred by having FAP advisors work one-on-one with Ministry personnel. For this reason it is not usually possible to separate what was training from what was some other kind of work.

1. *Specific measures*

Formal, classroom training covered a limited number of subjects. These were:

- Courses for managers, which were attended by 127 participants.
- Courses for programmers and systems analysts in UNIX, INFORMIX, CASE and FOURGEN. 54 people attended.
- Auditing techniques, which included the production and distribution of an audit manual.

141 people completed the course. From participants, two people were chosen as future trainers, and they, along with FAP trainers, taught additional classes. They now do this on their own.

- A course on management for auditors, supervisors and chiefs of audit sections. A manual was produced and distributed. 37 people completed the course.
- Formal courses, with instruction manuals, were created for DAF personnel on each of the revenue models, the general equilibrium model and on related topics such as macro-economic policy analysis and international trade issues.
- Courses on the new Income Tax and VAT (April and May, 1993) and their regulations, for 165 employees of DGRI and the Special Audit Groups (including Programa IVA). Most of these trainees were auditors and managers, but the group included some taxpayer service personnel.

It should be noted that the manuals developed for the courses on audit techniques and management have been officially adapted by the DGRI as the training materials for in-house training in the future.

2. *Comments*

Formal courses were all followed by evaluations by participants. Evaluations consistently show that participants believed the courses were well focussed on their needs, that the level of instruction and materials were first rate and that the technical level was appropriate. Since most FAP training occurred outside a formal setting, evaluation is difficult. However there are many signs that it was successful. These include:

- The Ministry has hired many people who worked with the FAP program as managers, supervisors and technicians. Indeed, many key positions are occupied by FAP-trained people (eg. Programa IVA, Informática)
- Directors and Subdirectors express confidence in the skills that their people have acquired and credit the FAP for providing those skills.
- Units that are staffed with those who were trained by the program seem to be functioning well without much FAP input. Furthermore, units that rely on these functions report good service.
- FAP resident advisors express great confidence in people they have trained and who are now functioning independently within the MOF.

Overall it appears that despite the small number of formal training exercises, considerable and

significant skill upgrading has occurred because of the FAP.

I. An Overall Evaluation

In general, the FAP team has fulfilled almost all components included in the terms of reference. Omissions have been few (eg. limited activity in budgeting) and several important activities have been added that were not specified in the terms of reference. (eg. the vehicles program, the "sistema bancario"). Furthermore the team has played a key role in the implementation of the tax modernization program. The team worked on many day-to-day implementation tasks in the Ministry, responded to the direct needs of the Minister and Vice Minister, and took the lead in establishing regulations to fit the new tax laws.

Despite the FAP activities, the ability of the MOF to administer taxes remains weak in many ways. The DAF is still too weak to provide much substantive input into policy making. Very little improvement has been institutionalized at the DGA. Organizational changes recommended by the FAP have generally not occurred. Auditing remains a very weak activity. The MOF appears to pay very little attention to the detail that would allow them to bring to bear the many tools provided by the FAP.

V. ACHIEVEMENTS AND PERSISTENT PROBLEMS IN THE MINISTRY OF FINANCE

Observations made in the preceding sections are oriented narrowly around the terms of reference with which the FAP team worked and whether or not the team did what they set out to do. Here our objective is different. The environment that the FAP team leaves behind will determine how permanent administrative will be. Our objective in this section is to indicate some significant factors that will help or hinder the MOF in successfully administering Guatemalan taxes after the FAP ends.

A. Achievements

1. *The Dirección de Análisis Fiscal*

The Dirección de Analisis Fiscal (DAF) was established as a permanent part of the MOF in April 1992. The DAF was a major component of the original FAP, but never got off the ground during the first two years of the project due to a lack of Ministry support. One of the conditions recommended for continuation of the FAP was that the DAF be created. The DAF serves as advisor to the Minister on issues related to the conduct of fiscal policy.

2. *Analytical tools*

Probably the most significant achievement of the FAP and of the MOF has been in the acquisition of analytical tools. It is probably the case that there is now no shortage of analytical tools in the MOF. The FAP has developed a wide range of analytical tools for application in the MOF, and, in some cases, that set of tools has gone beyond what was specified in the original project plan. Furthermore, there has been considerable institutionalization in the maintenance and use of the tools that exist. Tools fall in two general categories: computerization and analytical models.

Computerization at the MOF has changed dramatically from the centralized mainframe environment of a few years ago. With the recommendation of the FAP team, and then with its assistance, the DGRI and DGA have abandoned the mainframe environment and have installed open systems based on personal computer networks. This has greatly improved the capabilities of the units concerned. They now have full access to the information that makes possible the administration of a modern tax system.

Changes in the computer system have yielded great efficiencies for the MOF. For example, the Departamento de Informática estimates that in money alone there are savings of about \$33,000 per month associated with leaving the mainframe environment. On one item alone, the lease on the mainframe hard disk drive, the MOF now saves \$12,000 per month. One might ask, "How much should one be willing to invest to save (or earn) \$33,000 per month?", ie \$396,000 per

year. This return alone justifies an investment of around \$5.7 million¹⁴. In addition to this there are some intangible returns to the investment. *First*, training is much easier. Mainframe operators and technicians usually require higher level university training. There are probably very few people with this training in Guatemala. With P.C.s almost anyone can learn to use them. Training is cheap by comparison. *Second*, repairs and maintenance are much reduced. Furthermore, systems can be built as they are needed rather than having to invest "up-front". *Third*, information control is now in the hands of the users, rather than under control of a non-user who may not understand nor care about the eventual application. P.C. systems are more responsive to user needs.

Analytical models created by the FAP are now installed and in use by the DAF. DAF currently has available to it models of the following kinds:

- Income tax models that apply to natural persons and businesses.
- Indirect tax models which include sub-models for IVA on domestic consumption, IVA on imports and customs,
- A budget model which allows budgets to be monitored over the course of the budget year,
- An integrating model that takes input from those above so that revenue and budget, performance and forecasts can be compared,
- A general equilibrium model.

These models are under the control of the DAF and are used to produce frequent comparisons of planned and realized revenue and expenditure comparisons and forecasts. DAF staff have received considerable training from the FAP in the use and maintenance of the models. While these models are useful, there is a danger in overreliance upon them. The models are not very sophisticated in the way they must be used in Guatemala. While the models are capable of considerable analytical use, the data constraints on them limit the way they can be used. Some uses may amount to little more than summing the effect of a number of preconceived assumptions made by the user. The use of a model may give the appearance of sophisticated analysis when in fact the model simply covers up the fact that only a few unsubstantiated assumptions are being simulated.¹⁵

¹⁴ Since the shift from the mainframe was paid for mainly in dollars, the interest rate on dollars is the factor that determines how much one would be willing to invest. If that rate is 7%, then one would be willing to invest \$5.66 million.

¹⁵ Interviews with DAF staff, regarding a report from a modelling exercise revealed this to be the case. Results from the exercise were reported without analysis. The models were

4. *Institutionalization of Administrative Improvements*

One of the main findings of the FAP evaluation done in December, 1991, was that although the project team had offered many tools to the MOF, literally none had been established in a sustained way at the Ministry. This picture has changed dramatically. In the past two years many changes have occurred which institutionalize improved management tools and practices brought by the FAP. Statements about institutionalization are frequently subjective and no "test of time" allows any empirically-based judgements. Nevertheless, many steps have been taken by the MOF to install permanently the improvements designed by the MOF. These steps include:

- The Departamento de Operación Informática within the DGRI has been completely reorganized and restaffed. The organization is now oriented around providing efficient service to other departments. The staff has been well trained by the FAP. Indeed, many staff members worked as FAP staff during the course of the project. Staff compensation has also been improved (via contracts) to make it comparable with the private sector.
- Training is now occurring independent of the FAP. Important aspects of MOF operations such as auditing, and computer systems are now objects of indigenous training programs.
- Operations manuals have been produced for almost all departments of DGRI. Where manuals do not yet exist, there is a plan to produce them and actions are under way which will produce them. FAP staff is no longer involved in their production.

Institution building still remains (see below). But compared to what had occurred prior to 1992, considerable advance has been made.

5. *Commitment of Significant Resources*

Within the past two years, the MOF has committed its own monetary and personnel resources to administrative improvements. This is in sharp contrast to what had occurred prior to 1992. Since the project's inception the MOF has spent \$3.4 million of its own cash on the project. Other support was given in kind. Table 5.1 shows amounts of cash and in-kind support reported for the project. Since the project's beginning the MOF agreed to spend about \$1.5 million in cash and \$4.5 million in kind to support the project. Actual support, as of the end of June, 1993 exceeded these amounts significantly. The MOF spent over \$3.4 million in cash and \$4.7 million in kind.

treated as if the tables that they produced should speak for themselves and required no critical comment. Staff seemed unaware that assumptions should be stated explicitly and that the implications of assumptions should be at least discussed. Indeed, what was reported in the document was in some ways misleading.

TABLE 5.1
MOF COMMITMENTS AND EXPENDITURES (\$)

	MOF Commitment	MOF expenses through June '93
CASH:	<u>1,530,769</u>	<u>3,414,127</u>
salaries	189,654	461,284
training	66,000	49,616
travel	66,260	88,497
eq. and supplies	957,052	1,327,071
other	251,803	1,487,659
IN KIND:	<u>4,469,231</u>	<u>4,719,829</u>
salaries	1,605,070	1,901,855
training	2,075,820	2,140,384
eq. and supplies	86,913	185,596
other	701,428	491,994
TOTAL FROM MOF	<u>6,000,000</u>	<u>8,133,956</u>
NOTE: AS OF 31/12/91		
Cash	82,212	301,708
In Kind	3,242,713	3,242,713
Total to 31/12/91	3,324,925	3,544,421

Source: MOF reports to FAP.

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Commitments of cash to a project are much more important than commitments in kind. Indeed, for an institution the size of the MOF a commitment in kind is almost impossible to fail to make. One need simply state that expenditures that are already being made are being made to benefit the project. Contributions in kind are almost meaningless. Contributions in cash may be meaningful if the cash would not have been spent otherwise. Surely some of the \$3.4 million in cash spent would have been spent anyway, but just as surely some of it would not. The fact that most of the cash attributed to the project went for "equipment and supplies" (mostly computer equipment) and "other" (mostly contract employees) is an indication that some significant commitment was provided to the goals of the project.

It is interesting to note that during the first two years of the project almost no monetary commitment by the MOF was required by AID, and, as we have noted in Section 2, almost no commitment of any kind was forthcoming from the MOF. The lower part of Table 5.1 shows that AID expected the MOF to spend only about \$82,000 in cash on the project in its first two years. While in fact the MOF reported spending about \$302,000 these figures could easily have been gained by reallocating monies already being spent. Since the AID component of the project came as a grant, the project was basically free to the GOG. Little commitment was required of the MOF and it is not surprising that almost nothing was forthcoming.

In addition to the cash expenditures that were made out of MOF budgets, additional spending was made out of PL-480 funds. A total of Q11 million was spent as shown in Table 5.2. Expenditure of PL-480 funds is not a very demanding commitment since the funds are grants from the US Government in the first place (and their expenditure is normally inflationary). Also, PL-480 funds can only be spent once and are therefore poor substitutes for covering recurring expenses. Some of the PL-480 funds spent will probably have little permanent impact. It is difficult to evaluate the impact of Q3 million on publicity. Q2.58 million is being spent on employees contracted to perform audits (Q1.5 million) and on contracts with audit firms to conduct special audits (Q1.08 million). Clearly this is not a permanent solution to the audit problems of the Ministry. The bulk of the PL-480 funds (Q5.3 million) were spent on computer equipment, system upgrades and software which will surely have some enduring impact on the MOF. But some of these monies were wasted as well. One contract for Q800,000 was let to a private firm for the development of software that could be used by VAT taxpayers. The plan included a Q250,000 expenditure to reproduce 20,000 diskettes for distribution to VAT payers who are interested in using it to file their VAT. Unfortunately, there are probably not 20,000 computer systems in Guatemala and the software is already available commercially.

Additional evidence MOF commitment include the following:

- Of late the MOF has been paying all the expenses of the FAP office (eg. vehicles, computers, ect.)
- Monthly FAP staff reports show considerable support from the Vice-Minister of Finance assigned to the project. He has repeatedly and strongly supported the FAP team in their activities. Also, his own ideas have been shaped by FAP input.

TABLE 5.2
PL-480 FUNDS SPENT BY MOF ON FAP

	million quetzales
Publicity	3.00
Contract audit personnel	1.50
Contract with audit firms	1.08
Training	.12
Computer equipment	5.30
TOTAL PL-480	11.00

Source: MOF

- Formation of the Programa IVA shows that implementation of the new VAT law is being taken seriously. The Programa IVA required not only an input of money, but a willingness to deal with the potential disruption that the creation of an oversight group, outside the normal administrative hierarchy, may create.

This list is not meant to imply that commitment by the Ministry and its sub-divisions has been perfect. It has not. (see the next section) But compared to what occurred during the first two years of the FAP, a considerable increase in support is evident.

B. Persistent Problems

Any tax structure is given real meaning by the way it is administered. Tax policy is established via the tax administration system and, as such, there is no way to separate the two. The tax reform package which went into effect July 1, 1992, goes a long way toward providing Guatemala with a more rational tax structure, but structure itself will have little meaning without simultaneous administrative reform. Indeed, tax collections in Guatemala under the new tax structure probably fall far short of what they would be if administration were effective. The administrative dimension has long been overlooked by most public finance experts. Rather than being conceptual and "clean", tax administration is "grubby" and cannot be modified overnight. For the FAP to have meaningful and long-term impact on Guatemala's public finances, this administrative dilemma must be squarely confronted and improved.

1. Tax Revenues may not be Increasing Dramatically

At almost all levels within the MOF there is the impression that all is going well because tax revenue collections so far in 1993 exceed those for a similar period in 1992. This comparison may not be legitimate and may in fact hide cause for concern. Problems are several. *First*, comparing all of 1993 with all of 1992 hides distinctions between tax structure and tax administration. For the first six months of 1992, the tax structure was different from what it was in the first six months of 1993. For those months comparisons mix differences due to structure *and* administration. Comparisons of periods after July 1, 1992 with corresponding periods in 1993 do not involve tax structure changes. *Second*, by looking at total tax collections, important differences between taxes are hidden. *Third*, comparisons that ignore inflation do not deal with real changes. Furthermore, no account is taken of what is expected with tax revenue as GDP increases. Normally, one would want tax structures that are slightly "elastic", i.e. that increase slightly faster than GDP increases in real terms.

Table 5.3 shows data provided by DGIR on internal revenues by source through September, 1993. We are particularly interested in the income tax and the VAT which were the major objects of the tax reforms that went into effect in July 1992, and major objects of the FAP. Total income tax collections have risen by 29.7%, which significantly exceeds inflation (about 14%) plus growth in GDP (about 3%). Collections of the personal income tax are down considerably, but this is to be expected. The reforms of July, 1992, provided a new deduction from taxable

TABLE 5-3
INTERNAL TAX REVENUE THROUGH SEPTEMBER 1993. (millions of quetzales)

	1992, through september	1993, through September	difference (%)
Total income tax	649.5	842.2	+ 29.7
business	536.5	761.7	+ 42.0
personal	113.0	80.5	- 28.8
VAT on domestic	464.5	515.9	+ 11.1
others	765.9	796.3	+ 4.0
TOTAL DGRI	1879.9	2154.4	+ 14.6

Source: DGRI

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personal income for VAT paid (up to 7% of income), ceased to tax dividends and raised the standard deduction. VAT collections on domestic sales has increased by only 11.1%, which does not keep up with inflation, let alone provide for growth in the tax base. One would have expected the VAT revenues to expand much faster because of broadening the base, but this has not been the case. Other internal taxes together (which had generally not been the object of reform) have fared worse. They are up only 4% in monetary terms (down about 10% in real terms) and constitute over one third of the entire internal tax take. This is serious erosion of tax revenues. Over all, internal revenue is up only 14.6% in 1993, compared with 1992. This has been almost entirely offset by inflation in the intervening period.

Table 5.4 shows similar information. When comparing the January through June periods of 1992 and 1993 we are comparing periods between which *both* tax structure and administration have changed. When comparing July and after for each year we are comparing the same tax structure. Since the tax structural change between the two periods broadened the tax base after July 1992, we would expect a sharp jump in tax revenues when comparing the first half of 1992 with the first half of 1993. Indeed, this occurs with each of the taxes shown. From July on in both years tax structure is the same, so we can see the effect of tax administration, uncluttered by changes in structure. As we have already observed, revenue from the VAT on domestic sales is declining in real terms, while the VAT on imports is increasing. The latter increased by almost 23% for the July-September period of 1993 over 1992. This is probably due to the greater ease of identifying and taxing imported items when compared to all goods and services produced domestically. But, VAT revenues on domestic sales is up a scant 4.9% in July-September 1993 over the same period in 1992. This falls far short of inflationary increases in the tax base and allows nothing for normal growth. Income tax¹⁶ revenues in this period increased by over 33%, keeping them well ahead of inflation and the effect of real economic growth.

In short, it appears that administrative problems may be occurring with the VAT on domestic sales and with internal taxes other than the VAT and income tax. People within the MOF blame the poor VAT performance on the political problems of May-June, 1993, and/or on the expectation of a tax amnesty. These explanations would only hold up if the same problem occurred with the income tax, which does not seem to be the case. Complacency within the Ministry may also be unfounded for other reasons. *First*, VAT credits accumulated prior to June 30, 1992 could not be carried over after that date and many of the cases claiming VAT credits are still being audited¹⁷. There are about Q230 million in VAT credits outstanding. When these

¹⁶ We attempted to compare revenue collected from both the business and personal income taxes for the periods July through September for 1992 and 1993 as we did with the VAT. Such a comparison is not possible. Two factors created incomparability between the two periods for the personal tax. First, the schedules for filing and paying estimated taxes (pagos a cuenta) changed between the two periods; second, for the first half of 1993 there was a question before the Supreme Court as to the constitutionality of estimated tax payments. During that period estimated tax payments were not made.

¹⁷ This is a problem in itself and will be mentioned below.

TABLE 5.4
COMPARISONS OF PRE- AND POST-TAX REFORM REVENUE COLLECTIONS
(millions of quetzales)

	1992 Jan-Jun	1992 jul-sep	1993 Jan-jun	1994 jul-sep	% 1	% 2
VAT (dom)	289.6	174.8	335.9	183.4	16.0	4.9
VAT (M)	310.7	214.0	464.3	263.0	49.4	22.9
Income (t)	463.2	186.3	600.7	248	29.6	33.1

Source: DAF. August data are preliminary and September's are estimated.

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are approved, the VAT credits can be used for payment of current VAT or other tax obligations. The MOF will be collecting script, not cash. *Second*, The emergency bonds issued in 1991 may be used to settle tax liability beginning in September 1994. Since these bonds carry below-market interest rates it is likely that they will be used for this purpose. (the amount here is not large ... about Q40 million). *Finally*, statements by the Minister (La Prensa Libre, Oct 29, 1993) that an extra Q50 million can be collected in the remainder of 1993 by special audits, is not likely to be true. Even if the audits were complete now and demand for payment made immediately, it is not likely that payments would occur before 1994. Unfortunately, the audits have not yet begun.

Overall, tax revenues relative to GDP may not be increasing. World Bank data show that during the decade of the 1980's tax revenues averaged 8.0% of GDP. In 1992, tax revenues were 8.3% of GDP. The DAF has made forecasts of tax revenue for 1993, based on actual collections through September, and forecasts for only the last three months of the year. In part those forecasts are based on the GDP forecast made by the Banco de Guatemala. Given the DAF revenue forecast, and the GDP assumption upon which it is based, the DAF is implicitly forecasting a tax revenue to GDP ratio of only 7.9% for 1993, about the same ratio that existed in the years 1985-89.

2. *Administrative Problems in the DGRI*

One of the greatest problems for the Ministry is *personnel policy*. Salaries in the MOF are set by the Civil Service Law, and their steadily diminishing real levels over the past 15 years have generated a migration to the private sector of the most qualified personnel. Moreover, low compensation multiplies the incentive for corruption. Personnel policy must be greatly solidified by providing career-path options to the most qualified administrative and technical persons in key DGRI departments. The ideal will be to offer a compensation package similar to that presently provided by semi-autonomous agencies such as the Central Bank or the Superintendencia de Bancos. This will involve a shake-up of salary scales and compensation packages, and the political barriers to doing so cannot be underestimated. Unqualified and poorly motivated people have been one of the primary problems for the FAP. Sustainability of FAP achievements depends on a Ministry commitment to assign qualified and motivated people to permanent positions, to work with the FAP-inspired improvements, and to attract these people to pursue careers in the Ministry thereafter.

The MOF has gotten around the civil service pay scale by relying heavily upon contracting for the personal services of qualified people. Indeed, entire departments (informática, DAF, Programa IVA) are now staffed by contract employees. While this shows that the current minister is committed to administrative improvements, a system of contracting personnel outside the normal civil service is also fragile. Should ministers change, and with that a minister's views on administrative matters, the personnel situation could change rapidly. The modernized tools and procedures installed by the FAP are not likely to be well handled by poorly paid public servants. Furthermore, the skills required in the new environment are easily transferred to the

private sector. Elimination of the contracting-for-services option would cause an exodus of skilled people out of the MOF to the private sector.

In addition to personnel problems, but related to them, the constant *updating of data bases and the immediate data entry* of information from tax returns are prerequisites to any continuous efforts at tax administration. Over the course of the FAP a great deal of progress has been made on the data base development front, and data entry backlogs have been reduced. Nevertheless, the data bases as they presently exist are incomplete. Superfluous data are generated, as there exists a lack of coordination between what the data users need and what is actually generated. Finally, data must be continually updated to be useful. Monthly reports by FAP staff show continual problems with data not being entered in a timely manner, little attention to detail in data entry and lax supervision of data handling.

3. *Auditing Procedures and Practices Are Very Weak*

There apparently has never existed a permanently implemented audit program in the MOF. This has been due to the lack of personnel, know-how, and commitment as well as to deficient data bases. Several data bases now exist to develop such audit programs, although more work must be done on some of them. Sporadic block canvassing (sweeps) have been carried out, but follow-ups after identification of stop-filers and non-filers have been very weak. No plans to do consistent and chronologically sequenced auditing have ever been implemented. FAP staff report that little initiative is taken by auditors to analyse what it is that they are doing, reducing their job to merely making sure that all the blanks on forms are filled in and that numbers add up. Audit output/productivity is low, and effective supervision is deficient; audit plans and audits actually conducted are of low quality.

The audit situation may be about to change with the reorganization of the Dpto. de Fiscalización in the DGRI and the establishment of the "Presencia Fiscal" program. Implicitly, the Minister has recognized that auditing in the DGRI, especially regarding the VAT, simply is ineffective. This recognition came in the form of the creation of the Programa IVA, which is directly responsible to the Minister and is charged with developing an effective audit program, by-passing the VAT Department auditors if necessary. Meanwhile, its longer term objective is to install the Presencia Fiscal program which creates a functioning cadre of auditors with clear means and methods to enforce tax laws.

4. *Administrative Problems in the Dirección General de Aduanas*

The different areas and departments into which the presently constituted DGA is divided make little functional sense. Moreover, some of these departments are hardly functioning at all, due to the lack of personnel and/or well defined responsibilities/tasks. The FAP has designed a well thought out structural reorganization plan which has been accepted in principle by the DGA Director (who was replaced on November 4, 1993). This is not really the fundamental problem

in the DGA. Just as in the case of the DGRI, the shifting around of boxes in an organizational chart is useless unless accompanied by serious and sustained efforts to improve the quality of the human resources. Personnel policy must become the main thrust of action on the DGA front.

The DGA must be able and willing to take concrete steps toward establishing career-path employment for its employees. Among other things these steps include adequate compensation packages and working conditions and constant job-related and on-the-job training. The personnel problem may be initially attacked by hiring people under contract just as occurs in the DGRI. But adequate funding for these reforms must also be guaranteed, and if it is otherwise impossible to generate such funding via the normal budgetary process, earmarking a given percentage of customs revenues might be adopted. After all, this will certainly yield a high benefit-cost ratio (in terms of revenue produced vs. revenue diverted to customs). However, this solution is not highly recommendable.

A new structural organization and the personnel filling the boxes will be in dire need of training in all aspects of customs processes. This training should be imparted hand-in-hand with the spread of computerization throughout the entire DGA. As always, it should be practical job-related training. The valuation and classification functions represent a significant task, and they are conspicuous by their low quality. Several other specific areas of difficulty for the DGA include:

1. The FAP has created a computerized data bank for vehicles which has almost full coverage, but rudimentary computerized data bases for most other import categories simply do not exist. The long-run task of creating a computerized data base for these other categories and training people in their use must be of utmost priority.
2. A 1989 law offers import duty and income tax exemption to maquiladoras which reexport their finished product outside the Central American area. The DGA has accounting and factory control responsibilities over these operations. However, controlling exemptions of this kind is a very difficult task. With the exception of a ten factory pilot current account system initiated by the FAP during 1991, the DGA is unable to monitor commodity and goods flows, which requires computerization, inspection teams, and training.
3. Actual transit controls are very lax, be they over merchandise which enters Guatemala via its ports or merchandise in transit through Guatemala. The DGA does not have its own warehouses, so that it must depend on private bonded ones in which the DGA has a post. Random inspection procedures are essentially nonexistent. The FAP has developed a pilot program to control transit between the main port and Central Customs in Guatemala City, but much remains to be done.
4. Audit controls do not now exist as such in the DGA. The audit control responsibility covers the carrying out of formal and consistent physical inspections in addition to financially auditing the operations of the numerous DGA units. To do this, an Audit Unit will have to be established.

A discussion of technical assistance to the DGA echoes suggestions already mentioned above for the DGRI. The modest steps taken over the past several years toward improving administrative deficiencies in the DGA must be totally ascribed to the presence of two external TA projects, the FAP and SIDUNEA. In June, 1992, the work of the latter terminated and was handed over to DGA authorities. Since then the FAP has assisted the DGA in further adaptation of the SIDUNEA to DGA's needs. Almost all technical improvement in the DGA is because foreign advisors have taken the initiative to install new capabilities. Almost no effort has been exerted by DGA. The DGA has not appointed counterparts to work with the advisors, and there is no obvious DGA person to carry on after the advisors leave. It is not likely that much will continue after the FAP ends.

5. *Problems with the Tax Code*

The Tax Code in Guatemala is a major constraint on what can be gained by applying the administrative improvements offered by the FAP. The Tax Code defines the procedure, facilities, appeals, penalties and other important key issues for tax enforcement. Like other Central America countries the Tax Code adopted by Guatemala in 1991, is based on the so called "unified project" prepared by the Organization of American States. This tax code can create more problems that it solves. The unified project specifies a series of repetitive and unnecessary procedural rituals that do not necessarily provide the taxpayer with protection against an unjust settlement, but it does provide many opportunities for taxpayers to paralyse the process or delay its resolution inordinately. Computerized information systems may be of little use under these circumstances. Even if the information system quickly, justly and precisely calculates taxes due, a settlement is not allowed and can be tied up for a very long time. Often a settlement never occurs as cases get lost in the bureaucracy. Even if it does, the absence of inflationary factors on penalties in the unified code can sharply reduce real tax collections.

The tax code does not give DGRI much power of enforcement. Rather than creating a powerful enforcement mechanism after an official tax assessment has been made, a lengthy appeals procedure is specified. There is little basis for prosecuting tax evaders (criminal penalties for tax evasion are not clear) and businesses cannot be closed for tax irregularities. Taxpayers can use a number of procedural delays on delivery of information to make auditing their cases difficult. *A draft law to modify the tax code* has recently been prepared but as currently drafted is probably unworkable. The draft criminalizes tax evasion, but that implies that many if not most Guatemalans would probably be subject to criminal penalties, and the draft law would therefore not be enforceable. At worst the draft law could be used as a means of punishment for selected individuals. The draft law also proposes a panoply of fines for a large number of infractions. Again this is probably unenforceable. There are too many small fines for too many kinds of infractions. At worst these open terrain for corruption.

If there is to be modifications in the tax code one should keep in mind the advice of Richard Gordon (1990) when he observed that there is often "...too much attention (paid) to the size of penalties and not enough to the likelihood of being caught. Without a large number of audits there

will never be a credible threat and without such a threat the imposition of sanctions is not only a paper tiger but undermines the legitimacy of the system." (p461). *Changes in the tax code* should therefore have the following properties:

1. Only the most egregious kinds of tax fraud should be subject to criminal penalties.
2. Fines should be few, but significant and easy to determine.
3. Business closures should be one of the penalties for VAT non-compliance. Closures should be a minimum of three days.
4. The appeals process should be shortened. Complicated and repetitive procedures should be removed.
5. Tax amnesties should be prohibited¹⁸.

Part of the difficulty of tax control in Guatemala stems from the sharing of tax enforcement by DGRI with other agencies. The financial sector and insurance companies are subject to tax audit by the Superintendency of Banks; cooperatives are audited by the Superintendency of Cooperatives. There is little cooperation between these groups, and some evidence of "turf wars". Such arrangements introduce complexity to the coordination of overall tax administration. Further complications flow from the constitutional guarantee of banking secrecy. Legal interpretations have been that DGRI auditors do not have access to bank account information, even in cases where fraud is reasonably suspected.

6. *Problems in the Ministry of Finance*

Not all divisions of the MOF have received attention from the FAP. Indeed, FAP has been heavily involved in the DGRI, DAF and DGA. Outside these divisions work proceeds as it always has, slowly, uncertainly and with little professionalism. The Ministry has become imbalanced in its development. Since tax revenue collection depends on some units outside DGRI, the process can only occur as fast as the slowest unit operates. Efficiency within the DGRI is constrained. Many of the improvements in the DGRI and DGA are fragile. They depend on the good will of the Minister to keep funds available for contract employees. Also, there are some lines of responsibility that are not clear and could threaten perpetuation of improvements. For example, the Superintendente de Informática is nominally superior to the

¹⁸ Tax amnesties have been used frequently in Guatemala and some attribute the slow growth of tax revenue in 1993 to the expectation of another amnesty. Bird and Oldman (1990) point out that "tax gadgets such as amnesties have little to offer developing countries... this approach is a loser." (pp.453-4)

Departamento de Informática in the DGRI. Exertion of power by the Superintendente could force the DGRI into computer solutions that are ill-advised.

A reorganization of the Ministry of Finance may be in order. The functional logic of all divisions should be examined. It might also be advisable to establish DGRI as an autonomous agency, with a director appointed by the President. It would then attend to its own technical needs and set its own salary scale and personnel policy.

7. *Trivial Things Create Major Problems*

Throughout its existence the FAP has been hindered by many trivial things that have caused major problems. This occurs throughout the Ministry. These seemingly trivial things illustrate the lack of attention to details that can constrain any reform attempt. Until someone is willing to deal with things at this level little progress can be expected. Removal of trivial constraints should be cheap when compared to the costs of major reform programs. Some examples include:

- When a computer fails at one of the customs locations, someone from the DGA computer department in Guatemala City must go to the site for repairs. That person can requisition a car and driver for the trip, but he receives only Q100 to cover expenses. The Q100 (total, not per diem) must pay for fuel for the car, repairs along the road (the cars are all in poor condition), expenses of the computer person and those of the driver. Clearly, neither the driver nor the computer person is overly willing to do their jobs, and overnight trips are out of the question.
- When a computer fails at a customs location, work stops until it is repaired. No goods enter or leave the country (legally). Trucks line up; perishables perish.
- Contracting for services has been used to attract qualified personnel to the DGRI. However, people being paid under contract must wait for 2 to 6 months for their pay to begin whenever a contract period begins. They will not be attracted for very long.
- During the full course of the project the FAP team sought space to store VAT documents waiting to be recorded. Requests were made repeatedly; promises were made. But, VAT documents are still stacked, in the way, in the work spaces in the VAT department.
- The customs offices have no computer paper upon which to print receipts and other documents. They require that shipping agents bring their own paper.
- There is often no one available or capable of printing a file, copying documents, composing letters or installing a program.

None of these items alone would be of great concern. But when one finds an inattention to details at all levels one's expectations for progress are dampened.

C. Summary

Overall, the problems of tax administration probably outweigh what has been achieved. A significant number of tools have been made available by the FAP and the Ministry's staff has been upgraded. However, much of the improved staff is temporarily paid through special contracts. Many of the tools are not being used to their full potential, and many of the uses made of the tools seem to be at the prodding of the FAP team. We fear that when the FAP team leaves, some of the tools will not be used. Meanwhile the Ministry seems complacent. There is overoptimism that things are going well because tax revenues are increasing. Closer examination reveals that that may not be the case. There is also overoptimism that the computerized tools created by the FAP can do more than is reasonable. The tools must be used and maintained. The work of tax administration must still be done by Ministry personnel paying attention to the details of administration (which the tools make easier). Ministry personnel seem to think that somehow the tools will do the work automatically. Unfortunately there seems little appreciation for what remains to be done.

VI. AN OVERALL EVALUATION

When the FAP was first evaluated at the end of 1991, several general issues for evaluation were specified in the terms of reference delivered to the evaluation team. For this final evaluation there were again a number of end-of-project issues that the team was instructed by AID to consider. We have decided to examine these issues now, after already examining the development of the project relative to the terms of reference governing the work of the FAP team. The reasons for examining an expanded set of issues is that the interests of AID go beyond the confines of a single project. Those interests extend to questions of project design and development in general. The end-of-project issues raised by AID in the terms of reference for this evaluation are:

1. **Implementation of the tax modernization program:**

This was a major contribution of the FAP team. The team's input to the Minister and Vice Minister was indispensable. In effect, the team created the implementation procedures. Much of the support work for development of the tax reform laws which were passed in early 1992 was based on this analytic assistance and on the personal efforts of the FAP team. Less positively, most of this work was done with little direct participation from the MOF. Indeed, few persons in the MOF had anything to do with developing the new tax legislation.

2. **Project effectiveness in the application of the analytical models, administrative reforms and training given by the technical assistance team:**

As the discussion in the prior sections of this study indicate, the FAP team was very effective in all of these areas. Where the FAP was less influential is in the area of structural reorganization. Though the FAP team continually promoted reorganization along functional lines, the MOF chose to ignore those suggestions, choosing a reorganization that has been characterized as "disfunctional".

3. **Did the FAP offer assistance in Developing the Analytic Infrastructure to Analyze the National Budget**

We presume that when AID states an interest in the "budget", the real interest is in fiscal performance, comparing income with expenditures. Herein lies one of the project's major accomplishments, especially on the income side. The development of the various microsimulation models and the carrying out of the specific analyses (the Technical Memoranda) lay a solid analytical foundation for Guatemala's fiscal administration. Installation of models (at the DAF) and easily accessible information throughout the DGRI makes analyses possible that were impossible before. Less progress was made on the expenditure side. FAP input into the budget process is probably minimal. However,

the FAP did influence the budget organization and presentation that made it much easier to understand.

At the time of this evaluation a "White Paper" on fiscal policy in Guatemala, required by the FAP terms of reference, had not yet been completed.

4. Training Plans and Programs Developed and Carried Out

The FAP project stressed training throughout, but the pace of training picked up considerably during the main project extension (ie. after July 1992). Specific training activities have been examined above. The utility of this training can now be seen by having entire key departments staffed by people trained by the FAP. MOF officials, from the Vice Minister down all express high regard for the FAP training and confidence in the qualified people left behind by the project.

One of the original components of the FAP was to make specialized graduate training available to selected MOF personnel. Georgia State University did request the MOF to submit candidacies for fellowships abroad, but no response was received.

5. Contribution to Building Institutional Infrastructure

Considerable progress was made in developing institutional infrastructure during the FAP extension. Since early 1992, the DAF has been formed and equipped, the computer department in DGRI has become well equipped, both with people and machines. Considerable amounts of MOF resources have been spent on contracting qualified people to perform specialized tasks and on the purchase of necessary equipment. This is in sharp contrast to the first two years of the project when none of this occurred. Much of the improvement must be attributed to the personal support of the Minister and Vice Minister.

6. Donor Coordination/Private Sector Participation

The FAP team has kept AID fully informed of its actions. Since all other donors must contact the Ministry through the Minister, FAP involvement with the other donors is upon the request of the Minister. The FAP team has on occasion met with representatives of the World Bank, IMF and IDB. The team is working cooperatively with the UNDP. However, the FAP team has not always been involved in the itineraries of the major donors. This has been either by choice of the Minister or of the various missions.

The private sector has little to do with most of the functions of the FAP team. However, the FAP team wrote materials for the Minister to use in explaining the new tax laws and regulations to the Congress and the private sector. FAP team members also participated in presentations to private sector groups on the new tax laws.

7. Performance of Collateral Projects

Formal donor coordination was weak despite the fact that the MOF appointed a coordinator at the beginning of 1991. Prior to that date the FAP at various times co-existed with four external aid projects located in the MOF: BID-CIAT, the German GTZ, a UNDP local administration project, and the SIDUNEA project in Customs. Coordination between the FAP and BID/CIAT took place on a person-to-person basis, and was generally harmonious and fruitful to the extent that the latter fully adopted the FAP approach to mainframe de-emphasis. The FAP-GTZ coordination was very poor, and the latter pulled out of Guatemala in mid-1991 due to frustration with the limited MOF interest in its work. In general, the FAP played the lead role in formally and informally coordinating donor policies and activities, stepping in where the MOF coordinated poorly or not at all. The BID/CIAT project ended at the end of 1992 and the SIDUNEA project in June 1992. Some BID/CIAT projects remained undone and FAP picked up the slack as required to meet FAP objectives. The FAP can take some credit for improving the performance of both the BID/CIAT and SIDUNEA projects.

As of the end of 1993, there is only one collateral project. The UNDP is now extending the tax administrative systems that were created by the FAP for the DGRI to Departmental locations. The objective is to decentralize tax collection procedures.

8. Improvements in Tax Administration

During 1990-91 there occurred no observable coordinated and integrated efforts by the MOF to improve tax administration, despite the presence of the FAP. The FAP itself could not be faulted, as the initial base commitment must flow from the MOF. What FAP achievements did come about were the result of grabbing certain "targets of opportunity". During the 1992- 1993 period advances were made. Information and people are in place who should be capable of administering the system. However, the Ministry is still weak. Inattention to detail and lack of follow-up in almost all activities is a severe handicap to effective tax administration.

9. Impact on Beneficiaries

This is a very subjective area. If the beneficiaries are viewed as the permanent staff of the MOF, many individuals benefited from exposure to the FAP advisors. On the other

hand, if the beneficiary is taken as the MOF itself, many functions have been strengthened considerably. However, divisions of the Ministry that did not participate (generally those outside the DGRI and DGA) have received little long-term benefits. Some of these units still constitute bottlenecks to effective revenue collection. Taking the Guatemalan taxpayer as the beneficiary, it is likely that taxpayers will receive long-run benefits from the more transparent and rational tax structure created by the new tax laws of 1992, which were generated via the constant advice of the FAP team.

The FAP had as a concern, an improvement in the equity of the tax burden and in public expenditures. The information available does not allow a very precise estimate of what the impact has been on equity. Nor have estimates of this dimension been made by the DAF. It is the case that the new tax laws have the potential for creating a more equitable distribution of the tax burden. The tax base has been broadened and legal means of tax avoidance have been removed. However, in practice the administration of the new tax laws remains very imprecise. It is likely, that in the way it administers the tax laws, the MOF does not take advantage of the potential for increased equity contained in the law. Imprecision in the MOF's administration makes it unlikely that any significant changes in equity have occurred in fact. As we have pointed out elsewhere, the FAP has had very minor impact, if any at all, on public budgeting and expenditure. Thus, no improvement in equity is likely on this dimension, nor is it likely that the FAP has had much impact on resource allocation through the budget system. These shortcomings are almost entirely due to the MOF's failure to use the tools and techniques that have been made available by the FAP, and not a result of the FAP failing to provide the necessary technical assistance.

10. EOPS of the log frame

We presume that AID is interested here in the "End of Project Status" as specified in the Project Paper describing the extension. (ie. Project Paper, Fiscal Administration Project, Amendment Number 1, March, 1992) The EOPS is specified there (p.14) and we will deal with each point in turn.

a. *"The GOG will have an efficient and income-elastic tax system. Overall tax revenue is expected to increase from 8.0% of GDP in 1991 to the range of 10-12 % of GDP in 1995. Subsequently, tax collections will increase in line with GDP."*

As we have discussed in Section 5.B.1, there has been no appreciable increase in tax revenues relative to GDP. It is not likely that targets will be met for 1995 given today's situation.

b. *"The policy analysis unit will be able to carry out the following activities:"*

(i) *"Evaluate the revenue impact of changes in tax legislation."*

Given the models at its disposition the unit (ie. the DAF) is probably capable of this.

(ii) *"Provide projections of revenue collections for both the present year and for the following year."*

The DAF is capable of this.

(iii) *"Provide expenditure projections for both the present year and the upcoming year."*

The DAF is not capable of this. The DAF receives information on budgets from other units within the MOF and its projections are therefore not independent of others.

(iv) *"Provide substantive input into the budget formulation process."*

The DAF will probably do this, though it is not clear that they have done so to date.

(v) *"Identify policy objectives," etc.*

The DAF does not appear to now have the capability to identify policy objectives, provide policy recommendations nor to quantify policy impacts in significant ways.

(vi) *"Analyse the macroeconomic situation of the country."*

The DAF does not do this, nor does it have the capability to do it. It is not clear that there was an intention for it to analyse the macroeconomic situation. The Central Bank provides this function.

(vii) *"Maintain an updated data base of the key macroeconomic variables."*

DAF does this by using data provided by the Central Bank.

(viii) *"Provide the Minister with written reports..."*

The DAF does this regularly.

c. *"Units will exist within the Ministry charged with monitoring collections of personal income tax, corporate income tax, value added tax and customs. Those units will be able to identify changes in procedures and regulations necessary both to ensure full compliance with the law and to resolve differences of interpretation."*

Units do exist within the Ministry as indicated. However, there is little indication that they can carry out the functions specified.

d. *"The Ministry will have a training program including both short-term and long-term training for Ministry personnel."*

The Ministry has no training program of this kind.

e. *"The Ministry will have a personnel policy that provides incentives (both monetary and non-monetary) for staff to remain in the Ministry. These incentives will be part of a modernized civil service system."*

This is not the case.

f. *"The Ministry will have trained auditors with more effective information sources from both within and outside the Ministry that cannot only increase the number of audits, but also raise significant revenues through more effective audit plans and collections."*

It is true that the Ministry now has trained auditors and the information sources to increase the number of audits, raise more revenues, etc. However, the information sources are not being used and it does not appear that in fact the number of audits, or their resulting revenue, are greater than in the past.

11. How did the project fit into the political strategy of the government?

The GOG had plans for a tax modernization program before the FAP team came on board. Indeed, a tax modernization program has been one of the centerpieces of conditions on IMF and World Bank activities in Guatemala. The FAP team played a central role in developing the tax modernization program.

Other political strategy of the government is hard to determine. The government has changed twice during the course of the project.

12. Mechanisms developed within the project to monitor its implementation

During the project each resident advisor was required to submit monthly reports to the Chief of Mission. Monthly reports were then summarized quarterly by Peat Marwick (Washington) and submitted to AID/Guatemala for review. This evaluation found those monthly reports to be very informative as to what occurred and why. In addition, detailed work plans were developed at the beginning of each phase of the project and these too were submitted to AID for comment and approval. The Chief of Mission continually reviewed work plans and monthly reports with advisors to keep the project oriented around the terms of reference and the goals of the Ministry.

13. Evaluate the Main Results that the GOG Expected from this Project

It is not possible to determine what the GOG expected, since there have been two changes of government since the project began. Expectations from four years ago are not available.

14. How Administrative Processes Were Improved

This is the main story of the text of this report. The main contributions were:

- Assistance in design and implementation of a more easily administered tax structure.
- Improved administrative tools.
- Improvement in skills.
- Greater administrative efficiency.

15. To what extent has personnel turnover affected project implementation?

Personnel turnover in the project team has been slight and has not affected the project's implementation. Change in the chief of party at the end of 1991 had no effect. Turnover at AID had no effect. Turnover in the Ministry created great difficulties for the first two years of the program. There were five different Ministers and five different Vice Ministers. This turnover almost paralysed the project during that time.

16. On the expenditure side, what were the main results out of this project?

Regarding budgets there is very little impact of the project. The budget presentation is now much shorter and easier to follow than had been the case in the past. Other than this there is little impact.

17. What were the achievements for the budgetary analytical infrastructure?

Insignificant.

18. What additional inputs, apart from programmed counterpart inputs, were required from the GOG to end the project?

None.

19. **What evidence exists that the FAP contributed to higher level USAID/Guatemala Mission objectives?**

The evaluation team has not been apprised of "higher level USAID/Guatemala Mission objectives." However, we assume that those goals include stimulating "development", which is normally thought of as combining economic growth with other factors that sustain growth and improved levels of living. It is not possible to assess the project's impact on growth (see point 21). If the "other" factors in development include improved efficiency and equity, then the FAP has made a contribution. The improved tax structure, if administered as designed should promote greater efficiency and equity. Efficiency in tax collection¹⁹ has probably improved within the Ministry.

20. **What relevant lessons can be drawn from the experience of this project?**

There are several lessons that can be learned from this project.

- a. *Tools are not everything.* The FAP has had more-than-expected success in installing computerized information systems at the MOF. Nevertheless, the will to use the tools does not seem to have increased simultaneously. It is the failure to use the tools that will hold back effective tax administration in the future.
- b. *Focus is all important in project design.* The FAP may have had too many separable activities under its terms of reference. Budgeting is separate from tax administration. If there is indeed interest in budgeting then it is worthy of a project focussed on it. The budgeting activity in the FAP appears to have been an afterthought, and probably should not have been included in the project. Customs administration, the development of the DAF and tax administration of the VAT and Income tax can all be separated into three activities. Failure to focus is a common characteristic of AID projects.
- c. *Commitment of the recipient is required.* AID required almost nothing of the Ministry or the GOG. This is particularly true of the first two years of the project. During the original project, the Ministry was expected to spend only \$82,000 in cash in project support. This amount could easily be met by switching the identity of spending from other categories to the project, without increasing spending. The AID contribution came as a grant, so there was no cost to the GOG. It is not surprising that there was little MOF commitment during the first two years of the project.

¹⁹ Efficiency in tax collection is usually measured in two parts. First, is the cost to administer the tax. This cost, borne by the MOF has probably declined. Second, is the cost of compliance on the part of taxpayers. Simplification of the taxes has probably caused this to decline as well, though information on this dimension is very sparse.

During the second two years, the cash commitment of the Ministry was much greater (though still modest). One would expect greater commitment to the goals of the project, and that is indeed what was found. Commitments in kind are meaningless. Ways can always be found to attribute expenditures that would be made anyway to a project.

The recipient should also be required to determine counterparts to work with project advisors. If there is no counterpart, projects should be terminated.

- d. *Day-to-day ministry work should not be responsibility of project advisors.* It should be clear from the outset that advisors are not to be used to make up for staff deficiencies.

21. *Did the project promote recovery and economic growth in the Guatemalan economy? Is higher economic growth anticipated as a result of the project?*

There is no way to answer this question. For the unresolved controversy in the economics literature see the influential book by Bird and Oldman (1990: pp. 23-26). The connection between taxation and growth simply cannot be made. Furthermore, even if there were some way to make that connection there are other factors that would prohibit it. *First*, the tax reforms have only been in place since July of 1992. The period since then is too short for any improvements in efficiency to be noticeable. *Second*, as the evaluation in December of 1991 has shown, the FAP achieved little as of that date. Again the time elapsed is too short to see any effect. *Third*, there is no appreciable increase in the real value of revenue collected in 1993, and therefore one could not build the case that there is greater public investment as a result. *Fourth*, whether or not growth is stimulated depends in large part on what is done with the revenues collected. The FAP had little influence on public budgeting, so one could not build the case that the project influenced the expenditure of revenues collected.

22. *Is the reformed structure and administration of the Guatemalan tax system sustainable in the future without further USAID assistance?*

This is two questions. *First*, the reformed structure of taxes is already embedded in law and regulation and is therefore sustainable. *Second*, the administration of taxes has been little reformed, and is therefore sustainable but not desirable. The administration does not lack for administrative tools, for these have been provided by the project, and are sustainable. What is lacking is the administrative attention to detail and organization which must come from the Ministry. It is the will of the Ministry that is most important now, and that is not likely to be influenced much by AID.

23. *Were the project inputs appropriate?*

The project inputs were appropriate. KPMG Peat Marwick put together a team of very well qualified and enthusiastic advisors to conduct the project. Their sub-contract with Georgia State University also resulted in excellent technical assistance. AID seems to have gotten good "value for money" on this contract. The input of hardware was also appropriate. The computer equipment provided by the project (some with Ministry money), along with the associated information system redesign has had a significant payoff. Estimates put the value of the investment in computerization at over \$5 million, when measured as the value of costs saved.

24. *Should more assistance be provided for continued policy reform and/or administration?*

Again, this is two questions. First, little need be done on policy reform. Important tax reform has already occurred. Proposed reform of the land tax is not worth doing. Reform of the tax code is appropriate, and that has been discussed above. Second, more assistance to administrative reform has little justification. Only resolve on the part of the Ministry, to use the tools at its disposition, will solve the most pressing needs of tax administration. Without that resolve, additional tools are not needed. If there is resolve on the part of the Ministry, *then* narrowly focused assistance in auditing, fiscal analysis, and customs administration may be justified. However, now is the time to test the resolve of the Ministry by letting it demonstrate that it is up to the task of administering taxes with the tools that it already has. If it does not take its own steps to improve its organization and attention to detail, then no additional aid will be productive.

VII. CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions

The Fiscal Administration Project has been a relatively successful project. Almost all conditions specified in the terms of reference for the original project and its extensions have been satisfied. In addition, the FAP took on many tasks that were not specified in the terms of reference. Some of the most important contributions of the FAP are:

- *Significant input to the GOG's tax modernization program.* New tax laws, covering Guatemala's most important taxes (IVA, Income Tax), and implementing regulations were designed, and written primarily by FAP advisors. Without them tax reform probably would not have occurred.
- *Computerized systems* in the Ministry of Finance have been modernized. Data management is now much improved over the old mainframe environment.
- A number of *control systems* have been put in place to assist the MOF in managing tax-related matters.
- *Training* has occurred in almost all functions of the DGRI and DGA. This is particularly the case in computerized operations and auditing.
- The *Dirección de Analisis Fiscal* has been established and its staff trained and equipped by the FAP to provide assistance to the Minister in the formation and management of fiscal policy.

Institutionalization of changes wrought by the FAP have occurred in many ways. During the first phase of the project little institutionalization occurred, but the pace of institutionalization picked up substantially in the past two years. Favorable signs of institutionalization include:

- The computer section in the DGRI (the Departamento de Informática) is staffed by people trained by the FAP and well equipped to perpetuate the improvements instigated by the project.
- The Ministry has committed its own resources to following up on measures suggested or initiated by the Project. Examples include the allocation of funds for contracts that will attract qualified personnel, purchase of required computer equipment, taking steps to install more effective audits.

Nevertheless, *institutionalization remains fragile and partial.* Signs of this include:

- Not all divisions within the MOF have been objects of the modernization brought by the FAP. FAP attention has been aimed mainly at the DGRI and DGA. Some divisions still operate in antiquated and counterproductive ways, and act as constraints on tax collections.

- Duplicate responsibilities remain in some areas, and the ascendancy of one may offset others. For example, within the DGRI the Departamento de Informática is key to maintaining the modern computer systems installed by the FAP. However, the Dirección de Informática is nominally higher in the hierarchy. Exertion of power by the Dirección could weaken the Departamento.
- Personnel have been upgraded and numbers increased with the use of special contracts rather than hiring through the civil service. Reallocation of budgets could easily terminate this practice without providing a reasonable alternative.
- Much progress has depended on the good will and support of the Minister and Vice Minister. Changes in the occupants of these positions could shift support to other areas.

Problems remain for the establishment of a truly modernized Ministry of Finance and tax collection system. Some of the important ones are:

- The *Tax Code* is very awkward and does not support effective tax administration. However, current proposals to modify the tax code stress too much the penalties and criminalization of tax evasion. Reform should stress simplicity in both determining fines and their application.
- *Tax audits* are still very weak. Audits are still by tax rather than being comprehensive. This is despite the consistent advice of the FAP team.
- A *functional reorganization* of the DGRI and DGA have never occurred. Reorganization along functional lines would greatly improve efficiency.
- *Greater institutionalization* of efficient procedures has occurred in DGRI than has been the case in DGA. Other divisions of the MOF have felt little impact from the FAP.
- The *DGA administration* will probably deteriorate without the FAP. Almost all gains in the DGA have been because of FAP initiative. When the FAP is gone there is not likely to be a sustained improvement in DGA.
- There is *little attention to detail and organization* at most levels in the DGRI, DGA and elsewhere in the MOF. Some details may seem trivial, but they are like links in a chain. The chain of tax administration is broken by weak attention to detail. Given this continued inattention to detail, and given the FAP team's continual stress on detail it is not clear that the MOF is willing to do what is necessary to efficiently impose taxes.
- *Optimism at the MOF* that all will go well after the FAP leaves is probably unfounded. MOF personnel think that because tax revenues are up compared to 1992, that administration has improved. However, differences between 1992 and 1993 are due mainly to changes in the tax structure, not to administration. Also, MOF personnel are overconfident that computerization will solve most of their problems. Computers and information systems are only tools, and the effort to use the tools is simply not being made.

B. Recommendations

While it is not the intention of USAID to extend the FAP it may be useful to other organizations to identify measures that should be taken as natural follow up on the FAP project. Some areas that might prove useful are the following:

- *Conditionality* might be used to strengthen institutionalization in the short run. International organizations offering financial support to Guatemala may provide short-run assistance to reform by making their assistance conditional upon factors that help guarantee the survival of measures that have not yet been completed and/or which are in a potentially precarious position. For example, the Programa IVA should be allowed to run its course. The Departamento de Informática should be guaranteed the position of serving the needs of the DGRI (rather than the Dirección de Informática). Maintenance of the improved staff via the use of special contracts should continue. Eventually the use of special contracts should be phased out as compensation and the need for professionalism become permanently imbedded in personnel policy. This is particularly important in auditing and computer system operations.
- *The Dirección de Analisis Fiscal* has not yet fully developed as a source of sound fiscal advice to the Ministry. They should be encouraged to focus on specific fiscal issues. They should not expand their activities outside of this area. Additional analytical training and/or personnel are needed.
- *Auditing* is a weak link, and additional support for it is required. Indeed, a project could be mounted specifically aimed at auditing. If this were done the temptation to extend into other areas should be resisted.
- *The Tax Code* makes the work of auditors and collections much more difficult than need be. The tax code should be modified to make procedures straightforward. Reasonable fines for non-compliance should be imposed, and imposition of them should be simple as well. The code should also provide for business closure to force compliance and prohibit tax amnesties. Increased criminalization of tax evasion is probably not necessary.
- *If there is additional assistance* it should focus on administering the Income tax and the VAT, or on customs. It should not extend to taxes that have not already been the objects of FAP attention. The IVA and the Income Tax are adequately designed and have broad bases. If they fail to provide adequate revenue it will be due to lack of will on tax enforcement. Attention to other taxes will encounter the same lack of will. The current proposal to redesign the land tax would be a waste of time. The proposed changes in the land tax are not well designed. The proposal calls for only the taxation of land; it eliminates taxation of the value of buildings or other improvements. Land taxation requires land registry and valuation, which does not now exist. The agency charged with land taxation (DICABE) would have to undergo great change.

APPENDICES

APPENDIX A
PERSONS INTERVIEWED

APPENDIX A: PERSONS INTERVIEWED

Estuardo Méndez Viceministro de Finanzas

Silvia Salazar Directora, Comisión IVA

Rolando Escobar Director de Rentas Internas

Carlos Núñez Subdirector de Recaudación

Maribel de Castro Subdirectora de Administración

Juan Blas Subdirector de Análisis Fiscal

Arcely Escobar Subdirectora de Fiscalización

Olga Manzanares Directora de Estudios Financieros

Neftalí Bautista Encargado del Departamento IVA

Angel Rodriguez Encargado Dirección Técnica de Presupuesto

Glenda de Mejía Directora de Inspecciones

Leda Echeverría de Granados Directora de Asesoría Jurídica

Hugo René Girón Encargado del Departamento ISR

Edgar Ramírez Centro de Informática Fiscal

René Escalante Proyecto Descentralización Tributaria y modernización

Nery Cifuentes Auditor

Gilda de López Auditor

Jorge de Leon Auditor

John C. Ramos Chief of FAP, KPMG

Jose Messina VAT expert, KPMG

Ana Vilma Pocasangre USAID officer

Tham Truong USAID chief economist

Alfonso Martinez USAID economist.

Carmen Quiñones de Ruiz . . . Chief of Income Tax Audit Department, Ministry of Finance.

René Escalante UNDP's Director of the Project of Improvement of Regional Units of DGRI.

Jose Domingo Enriquez local counterpart of FAP project in Customs, Ministry of Finances.

Julio R. Fong FAP expert in Customs computerization, KPMG.

Renato C. Paes FAP senior expert in Customs administration, KPMG.

Jim Westrick FAP computers expert, KPMG.

Marion Coburn FAP O&M expert, KPMG.

Lilia de Marín . . Head of the Office of Financial Studies and Appeals, Ministry of Finance.

Deputy Director of Customs Directorate

Head of the computer office in the Customs Directorate

APPENDIX B
MAIN DOCUMENTS AND BIBLIOGRPHY

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