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Country Development Strategy Statement

FY 1986

GUATEMALA

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Agency for International Development
Washington, D.C. 20523

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LIST OF ACRONYMS

AAPL	Approved Assistance Planning Levels
CRS	Catholic Relief Services
CACM	Central American Common Market
CECONSA	Centro de Consultoría, S.A. (Consulting Center)
CARE	Cooperative for American Relief Everywhere
DA	Development Assistance
DIGESA	Dirección General de Servicios Agropecuarios (General Directorate for Agricultural Services)
ESF	Economic Support Funds
EAP	Economically Active Population
FNDH	Foreign National Direct Hire Employee
FTN	Franja Transversal del Norte (Northern Transversal Strip)
FOB	Free on Board
GOG	Government of Guatemala
GDP	Gross Domestic Product
ICTA	Instituto de Ciencia y Tecnología Agrícola (Institute for Agricultural Science and Technology)
IDB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
MOA	Ministry of Agriculture
MOE	Ministry of Education
MOH	Ministry of Health
NBCCA	National Bipartisan Committee on Central America
OECD	Organization for Economic Cooperation and Development
PSC	Personal Services Contract
PVO	Private Voluntary Organization(s)
ROCAP	Regional Office for Central American Programs
SEGEPLAN	Secretaría General del Consejo Nacional de Planificación Económica (General Secretariat of the National Economic Planning Council)
SIECA	Secretaría Permanente de Integración Económica Centroamericana (Permanent Secretariat for Central American Economic Integration)
SDAF	Special Development Activity Fund (Peace Corps)
SDF	Special Development Fund (AID)
USDH	U.S. Direct Hire Employee

EXECUTIVE SUMMARY

A. Background

Guatemala is the most favorably endowed country in Central America. Its agricultural resources, plus possibly extensive petroleum and mineral resources, give its economy considerable potential for growth.

However, what is immediately striking about Guatemala is its wealth on the one hand and the extent of poverty for most of its population on the other. Three out of four Guatemalans are poor 1/. At least 66% of the Guatemalan population is classified as rural, and 72% of the rural population is engaged in agriculture. The poorest and largely indigenous population of the Western Highlands comprises at least 46% of the total population (67% of the rural population) with a density of 191 persons per square kilometer and only 19% of the good lands (0.2 acres per person). Guatemala's mortality rate is 10 per 1,000, one of the highest in Latin America. Life expectancy for the non-Indian population is 58 years, but for the indigenous people only 44 years. Of the most at-risk children (those under 5 years old) 85% are malnourished. Only 25% of the population has three years of schooling. In the Highlands, over 50% of the children aged 7-14 do not attend any school.

With the exception of the slums which have expanded around Guatemala City following the 1976 earthquake, poverty in Guatemala is rural -- particularly the abject poverty of the Highlands. The average Guatemalan of the Altiplano is an Indian whose livelihood is agriculture practiced on less than one hectare of land. He and his family of five or six live together with other relatives in a tiny shack built of adobe or sticks covered with mud. There is no nearby source of potable water, nor electricity, nor latrine. Only on rare occasions does he have access to medical attention, and his wife gives birth without medical assistance of any kind. Those of his children who survive to age 7 may be able to attend primary school from one to three years. In the community where he lives 50% of the children who die, die of preventable infectious or contagious diseases. Only half of the children have received any sort of vaccination. The food which he raises is inadequate to

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1/ The GOG National Economic Planning Council estimates that 73.5% of the Guatemalan population lives in a state of poverty.

meet the nutritional needs of his family and, at some point during the year, insufficient in terms of quantity. All of the children in his village suffer from some level of malnutrition and are easy prey to any epidemic.

Agriculture remains the dominant productive sector of the Guatemalan economy. Though its share of GDP had fallen since 1960, agriculture still claimed 26% of economic activity in 1978. Approximately 55% of the work force is engaged in agriculture. In 1981, 55% of total exports were unprocessed and semi-processed agricultural goods. In addition, much of the country's industrial production and manufactured exports has backward linkages to agriculture.

Manufacturing in Guatemala grew rapidly under the stimulus of the Central American Common Market (CACM). From 1960 to 1970, real growth in manufacturing averaged 7.9% annually, exceeding the growth of GDP by 2.5%. Manufacturing was a true leading sector, its share of GDP grew from 12.8% in 1960 to 16% in 1970. After 1970, however, the dynamic from import substitution was spent and manufacturing grew primarily in response to domestic and regional demand. From 1970 to 1978 growth averaged 6.1%, equal to that of GDP. From 1978 on annual growth dropped steadily to 3% in 1981. Manufacturing's participation in GDP in 1981 stood where it had in 1970.

Despite the structural transformations that have taken place in the Guatemalan economy since 1960, the engine of growth is still the traditional commodity export sector. Directly and through indirect linkages, 30% of Guatemala's GDP is accounted for by traditional commodity exports. Industry, although very important, is less significant. Of the total production in manufacturing, 82% is consumed within Guatemala, 10% is traded intraregionally and 8% is exported to markets outside the region.

B. Recent Economic Performance

In 1978, Guatemala entered one of the longest periods of economic recession in its history. From a 7.8% real rate of growth posted in 1977, the level of economic activity has slid consistently to enter the negative range in 1982. This decline is due to world economic conditions as well as conditions in Central America and Guatemala. The world recession, particularly that in the OECD countries, has played a crucial part in Guatemala's economic downturn. Manufactured exports to countries outside Central America experienced a sharp contraction in demand. Depressed profits in the United States and Europe have made investment capital -- an important item in Guatemala's balance of payments -- very scarce. In addition, the terms of trade have turned sharply against Guatemala. Three products -- coffee, cotton, and bananas -- account for about 50% of Guatemala's total merchandise exports. Prices for these products -- tempered on one side by sluggish world demand and on the other by good harvests -- have not kept pace with the prices of the goods Guatemala imports. The effect has been to contract domestic income and to contribute to disequilibrium in the balance of payments. The current account deficit in the balance of payments grew from a negative $262 million in 1978 to a negative $565 million in 1981. It would have grown even further in 1982 had not the government forced a contraction in imports, and thus domestic income.

Within Central America, a shortage of hard currency paralyzed the payments union used by member countries to settle their trade balances within the CACM, resulting in a contraction of regional trade. In 1981, the volume of such trade decreased by 12% in nominal terms (probably 25% in real terms) and in 1982 by another 16%.

Political violence in Guatemala -- and throughout Central America generally -- has effectively halted the flow of foreign capital which played a vital part in financing Guatemala's growth in the 1960's and 1970's. Net short-term trade credits turned negative in 1979, and in 1980 Guatemala ran a deficit on the capital account for the first time in 15 years. This problem was arrested in 1981 and 1982 by the use of commercial lines of credit facilitated by the Central Bank, by compressing imports through quantitative restrictions and through non-payment of short-term trade obligations.

The first casualty of the economic downturn has been public sector finances. To counteract the contractionary process, the government resorted to expansionary fiscal and monetary policies in 1979 to 1981. Public sector deficits grew from $68 million in 1978 to $638 million in 1981 (from 1.1 to 7.4% of GDP). Expenditures of this magnitude contributed to a deteriorating balance of payments situation. When net international reserves reached a dangerously low level in 1981, government policy shifted; expenditures on the capital and operational account were cut drastically, reducing the deficit to $410 million in 1982, about 4.7% of GDP.

The second casualty of the economic downturn has been the health of the private sector. Firms have cut back on capital replacement and expansion. Consequently, fixed investment in the private sector has dropped from 12% of GDP in 1978 to 7% in 1982. The explosive growth in banking system credit to the public sector -- from $118 million in 1979 to $802 million in 1981 -- has reduced the availability of real short-term credit to the private sector. Capital replacement has been delayed, and it will be difficult therefore to restructure the productive base to meet increased export demand when it comes.

The cost of the economic downturn has been heaviest in terms of unemployment and underemployment at a time when it is politically dangerous to allow such developments to take place. Between 1978 and 1982, over 250,000 people joined the labor force. Slow economic growth has forced these people to join the pool of open unemployment in the modern sector and the already vast pool of underemployed in the urban and rural sectors.

Fortunately, Guatemala has been spared high rates of domestic inflation. Inflation in Guatemala has been very modest; about 7% between 1979 and 1982 as measured by the GDP deflator; 12% as measured by the wholesale price index -- no higher than world inflation during this time. Two factors prevented upward pressure on prices from the expansion in domestic credit required to finance public sector expenditures. First, large foreign reserves allowed rapid increases in public sector expenditures without putting excess demand on domestic resources. Second, when reserves had almost disappeared, the government chose to maintain fixed parity with the dollar, thus forcing domestic adjustment to fall on unemployment rather than inflation.

C. Key Development Problems

The obstacles to our objective of broadly-based, stable growth with equity can be summarized into the following three basic problems:

-- Inadequate growth levels and participation in the benefits of growth

-- Rapid population growth

-- Financial instability/and balance of payments deficits

1. Inadequate Growth Levels and Participation in Spread of the Benefits of Growth

In 1982 Guatemala had the highest per capita GDP in the CACM, but its population is among the most ill-fed, uneducated and unhealthy in Central America. Adult literacy in the mid-1970's was 14 percentage points below El Salvador, the poorest country in Central America, and about half that of Costa Rica. The incidence of malnutrition in preschoolers was over twice that of Costa Rica. The infant mortality rate among the indigenous population in the Altiplano region in 1980 was 160 per 1,000 live births, a rate twice the average for Latin America and one that compares with Zaire. Guatemala has the worst income distribution in Central America. Income distribution data for 1970 -- the latest data available -- shows that in Guatemala the bottom 50% of the population earned the least share and the top 5% earned the greatest share of total GDP.

Therefore, even though real per capita GDP has increased 2 to 3% annually from 1960 to 1978, this growth did not reach the majority of the population. Guatemala lacks the mechanisms to redistribute the benefits from growth to the poor. One indicator is the percentage of the GDP spent on education. That figure in 1979 was 1.7%, one-half of what El Salvador and Honduras spent and one-fifth of what Costa Rica spent.

The Mission will address the inadequate level of growth and the spread of the benefits of growth through a strategy intended to improve rural incomes and productivity. Priority attention will be given to the Western Highlands, the Indian heartland, which is the area of greatest poverty. However, this focus will not be exclusive of other parts of the country where successful interventions can affect a more equitable pattern of growth. These programs will require, however, an acknowledgement by the government of the basic human rights of the indigenous population and a firm commitment to addressing the legitimate development needs of all Guatemala's people.

Improvement in agriculture, the primary source of employment and income, will be the paramount means of achieving the objective stated above. The Strategy over this planning period will seek to (1) improve the existing resource base through such activities as soil conservation, terracing, small-scale irrigation and forestry management; (2) increase the efficiency in the use of available resources by encouraging diversification, research, application of appropriate technology, cooperative development and more intensive use of existing land; and, (3) improve the agribusiness system including marketing, transportation/access networks, storage and handling facilities and cooperative involvement.

Achieving the objective of increased rural incomes and productivity will also be dependent on improvements in the human resources of the rural areas. The Strategy contains programs in health and education to address this need. Improved health will result from a reorientation of the Ministry of Health to public health/preventive medicine programs and by stimulating the private sector to provide effective basic medical care in the rural areas. In education the Strategy calls for assistance in making the basic education program effective in supporting economic and social development objectives. Emphasis will be given to rural primary education, particularly the bilingual education program, and to expand the non-formal education program.

2. Rapid Population Growth

The Guatemalan population is growing at over 3% per year (practically unchanged from the early 1960s). At that rate, today's population of 7.8 million will reach 12 million by the year 2000, leading to overwhelming strains on social services in an economy where they are already inadequate. Therefore an objective of the Strategy is to reduce the rate of population growth. However, Guatemala may be entering the transition period since births per 1,000 as well as deaths per 1,000 are falling albeit not at equal rates. If the births per 1,000 rate continues to decline the picture will not be quite as overwhelming by the year 2000.

Guatemala has no national policy for family planning. While the Government of Guatemala (GOG) does offer some family planning services and allows private organizations to operate in this field, it attaches no real priority to family planning. Private organization efforts while probably among the best in Latin America, are not sufficient to the need due to limited resources. Regular contraceptive supplies are practically non-existent beyond the major urban centers. Family planning studies indicate that 61% of women of child bearing age would be interested in limiting births; however, only 18% are actually practicing birth control.

The Strategy related to family planning will stress the voluntary nature of participation based on informed choice. Programs will be continued and expanded to spread knowledge on contraceptive methods and improve services throughout the country with special attention to the indigenous population within the Western Highlands where birth rates are high and user rates low. The private sector will continue to be the principal implementor of the family planning program with the GOG being asked to provide an appropriate environment in which the private sector can work.

3. Financial Instability and Balance of Payments Deficits

Guatemala does not face the same magnitude of external financial problems and foreign debt burdens that plague its Central American neighbors. In 1982, Guatemala's debt-service ratio was 12% compared to 28% for Honduras, 41% for Nicaragua and 133% for Costa Rica. It does not suffer persistent and intractable deficits in its public sector finances as do Costa Rica and Honduras. In general, Guatemala has moved a long way toward achieving equilibrium in its internal and external accounts in the face of a deep and prolonged world recession but at a severe cost to its own economic growth. To help maintain equilibrium, in 1983 the GOG negotiated a stand-by program with the IMF.

Measures included in the program aim to improve the foreign liquidity position of the Central Bank and to improve central government revenues.

Accordingly, the government introduced a value added tax to replace the stamp tax. Despite political (the reduction in rate following the August 1983 coup) and administrative problems in implementation of this new tax, it is expected to increase revenue yields and improve the efficiency of the tax system. However, the GOG will have to further reform its fiscal and monetary policies to improve revenues sufficiently to allow for increased investment in rural development. Secondly, means must be found to attract external resource flows to support higher import levels in the absence of greatly improved commodity export earnings. To achieve real per capita growth over the planning period will require a substantially increased capacity to import.

External assistance will be needed to provide for the foreign exchange necessary to finance imports at a level sufficient to sustain at 3-3.5% rate of growth in real GDP. U.S. assistance is not intended to fill the entire gap, but, together with non-U.S. official assistance, to provide an inducement to increase private sector flows sufficiently to finance the necessary import levels. A third objective of the Strategy, then, is <u>balance of payments equilibrium at higher growth levels.</u>

The Strategy proposes balance of payment support through ESF and P.L. 480, Title I, funding. Priority will be given to the foreign exchange needs of producers of non-traditional exports, particularly agro-industrial, while not neglecting the needs of the existing industrial capacity. Local currency would be used in part to create domestic lines of credit for the export sector, both industrial and agricultural, and the small farmer. In addition, local currency generations will be used to support long-term development objectives.

These key development problems have been analyzed in relation to the four Agency priority areas identified as leading to effective economic and social development (the "four pillars"), the LAC Regional Plan and the NBCCA objectives in Central America. Policy dialogue will be an integral part of the Strategy and as a continuing process throughout the period will be important to achievement of the objectives. Later in this Executive Summary the particular policy issues to be addressed are delineated. In Guatemala the private sector is relatively free and unencumbered by the type of governmental policies or structures which inhibit its development in many other less developed countries. The Mission will take advantage of this situation by involving the dynamic potential of the Guatemalan private sector in the development process for a large portion of the program. Technology transfer and research play important roles in the proposed strategy based on a program to increase rural incomes and productivity. Technology transfer flowing from appropriate research priorities is the cornerstone on which the DA program to expand and improve the rural productive resource base is built. Institution building is addressed specifically in the Strategy section of this paper and is clearly indicated as an essential means to provide for self-sustaining, long-term development. Participant training has not been singled out in the Strategy, but the Mission will continue to make use of participant training as a human resource improvement tool by incorporating training into all the activities undertaken when such training can have an effective impact. The large new regional training program proposed for Central America will be of importance to the Mission. Also, the Mission will continue its unique reimbursable training program directing GOG-financed training programs at specific development targets.

D. Policy Dialogue

The Mission will maintain a continuing dialogue with the government and appropriate private sector institutions on policy changes and adjustments necessary to foster long-term, self-sustaining growth with equity in Guatemala. Policy discussions will be linked, in most cases, to the entire assistance package -- DA, ESF and P.L. 480 -- rather than tied to any specific program.

Specific policy issues which will be pursued under the Strategy for this planning period are:

-- A clear set of national development priorities focussed on the rural poor.

-- Increased GOG development efforts, specifically a doubling (from 3% to 6%) of the percentage of GDP devoted to programs affecting the rural poor.

-- Removal of the anti-export bias that exists within the present rules, regulations and procedures (including the tax structures and exchange controls).

-- Establishment of effective export incentives.

-- Establishment of a land sales mechanism linking willing buyer and willing seller.

-- Improvement in land titling mechanisms.

-- Encouragement and support of private sector organizations, such as cooperatives, which benefit agricultural productivity.

-- Reorientation of the Ministry of Health to primary health care rather than medical care.

-- Basic medical care provided on a "fee-for-service" basis in order to attract the private sector in basic medical care in the rural areas.

-- Establishment of a national education policy which includes an important role for both bilingual and non-formal education programs as well as a commitment to comprehensive planning and administration.

-- Establishment of a national population policy which puts implementation responsibility primarily in the hands of the private sector.

-- Respect for basic human rights and return to free elections.

I. ANALYSIS

A. The Resource Base of the Guatemalan Economy

Guatemala is the most favorably endowed country in Central America. Its agricultural resources, plus possibly extensive petroleum and mineral resources, give its economy considerable potential for growth.

In agriculture, in comparison to other Central American countries, a larger share of land area is capable of high or moderate yields. The territory of Guatemala is 22% of the combined territory of Central America including Panama, but it contains 26% of the region's most fertile soils. Within Guatemala itself about 42% of the land is capable of high to moderate yields. The heavily populated land area occupied by the Central and Western Highlands (Altiplano) is mountainous and broken, but with much fertile soil suitable for labor-intensive cultivation of temperate climate food crops. The adjacent, well-watered lands at intermediate altitudes, often on the slopes of majestic volcanoes, are used for production of high quality coffee. The Pacific coastal plain (South Coast) has abundant rainfall and the most productive lands. Large mechanized farms predominate here, producing cotton, rubber, bananas, sugar cane and cattle. The land north of the Altiplano, the northern lowlands (including the Franja Transversal) and the rugged northern slopes, contain 40% of Guatemala's territory and has abundant rainfall but thin, acidic karst soils. This area is still relatively underdeveloped due to difficulty of access and the almost complete lack of infrastructure.

Guatemala's infrastructure base is better developed than most developing countries and will, with some improvements, support the expanded use of its agricultural and industrial resources. The country has a large exploitable hydroelectric potential estimated at about 40,300 MW, which, if harnessed, would be enough to satisfy all future power requirements for years to come. Nearly completed hydropower installations should sharply reduce the need for imports of petroleum fuels for power generation in 1985 and beyond. Guatemala is not a major petroleum producer but its wells supply an amount equal to approximately one-fifth of its present consumption. Proven reserves are limited but exploration activities continue.

The transportation net includes both rail and road systems. Paved all-weather roads run North-South and East-West connecting ports on both coasts and the neighboring countries. The rail system parallels the road net but is badly rundown and presently underutilized. The secondary and tertiary road network is poor, especially in mountain areas; and the northern lowlands are practically without road or rail transportation.

Guatemala City -- the center of manufacturing and commercial activity -- is well serviced by power, water and telecommunications. While these resources exist outside of Guatemala City, they will need some improvements to adequately support a dispersion of major industrial and commercial activity in other parts of the country. Industry accounts for nearly 14% of GDP but operates behind a high wall of protective tariffs, is heavily dependent on imported inputs and is a poor contributor to exports.

Guatemala is unique in Central America with respect to its resources for tourism . The remains of the pre-Columbian Mayan civilization at Tikal, the strongly rooted culture of the indigenous peoples of the Highlands and the beauty of the scenery around the Highland lakes offer a variety of tourist attractions only a short distance from the United States.

Human settlement and economic production reflect these facts. More than 60% of the Guatemalan population is rural; agriculture is the leading contributor to GDP and exports; and agriculture is the major source of employment in the economy.

Thus, the picture of the country for the CDSS planning period and beyond into the 21st Century is that of a largely rural country reliant upon agriculture and agriculturally-related economic activity for domestic food consumption, employment and export earnings.

B. Recent Economic Performance

1. The Magnitude of the Crisis

From 1960 to the end of the last decade Guatemala enjoyed almost uninterrupted economic growth. In the late 1960's, spurred on by import substituting industrialization within the Central American Common Market (CACM) and bouyed by favorable commodity prices in world markets, the economy averaged 5.5% real growth annually. In the 1970's, the region experienced another boom in export commodity prices and agriculture led the economy to growth rates that averaged 6% annually. Throughout this period foreign capital flows were more than adequate to finance new investments in productive sectors and to close the gap in the balance of payments.

But in 1978, the Guatemalan economy began a long slide from the 7.8% real rate of growth that it posted in 1977 (see Table 1). For four consecutive years, the economy witnessed declining growth rates and in 1982, the level of economic activity contracted as growth entered the negative range. In 1983 GDP declined by another 2% demonstrating that the economy had yet to bottom out in this recession. The economic slump in Guatemala has been broad based, but manufacturing and construction have led the decline. Agriculture fell by 2% in 1982 and 2.5% in 1983. Manufacturing, however, fell by 2.5% in 1982 and 5% in 1983.

Construction, which has strong links to manufacturing, accounted for 5% of GDP in 1981 but fell by 18% in 1982. Thus the contractions in regional trade and in construction, were the major factors in the reduction in manufacturing output.

2. Causal Factors

The explanation for the downturn in the Guatemalan economy can be found in world economic conditions as well as in political conditions in Guatemala and elsewhere in Central America. The world recession, centered in the OECD countries, has played the major role in the recent reversal in Guatemala's economic fortunes. The terms of trade have turned sharply against Guatemala; the industrialized countries are buying less and at lower prices while world inflation continues to raise Guatemala's import bill. Three products --coffee, cotton and bananas-- account for about 50% of Guatemala's total merchandise exports (see Table 2). Price increases for these products --tempered on one side by sluggish world demand and on the other by good harvests-- have not kept pace with the prices of the goods Guatemala imports. The price of bananas has increased 43%, but the price of coffee has declined 15% between 1978 and 1982 and the price of cotton has remained unchanged. Meanwhile, import prices have increased by 5 to 10% a year. The effect of these trends has been to contract domestic income and to contribute to disequilibrium in the balance of payments.

TABLE 1: GUATEMALA: GDP BY SECTOR OF ORIGIN AND EXPENDITURE, 1977-83
(In 1970 $US Millions)

	1977	1978	1979	1980	1981	1982 1/	1983 2/
Primary Production	771.6	798.3	825.9	845.8	850.4	836.1	815.8
Agriculture	768.0	792.7	815.8	828.5	839.4	823.7	803.1
Mining	3.6	5.6	10.1	17.3	11.0	12.4	12.7
Secondary Production	613.5	651.8	690.1	725.4	730.0	677.4	654.1
Manufacturing	470.2	500.8	529.3	539.2	544.8	577.8	506.9
Construction	104.1	107.7	114.8	119.1	138.2	113.4	101.4
Public Utilities	39.2	43.3	46.0	47.1	47.0	46.2	45.8
Services	1507.8	1587.3	1664.5	1728.5	1748.6	1699.0	1678.8
Transport	144.6	155.0	163.2	176.6	175.7	169.3	166.6
Commerce	815.6	852.1	876.4	891.6	895.1	840.5	808.6
Finance	61.0	65.9	78.7	82.2	83.5	85.0	87.0
Housing	131.7	140.7	145.7	150.1	153.8	157.8	162.4
Public Administr.	164.0	173.0	184.6	204.1	215.6	219.0	224.5
Other	190.9	200.6	215.9	223.9	224.9	227.4	229.7
Gross Domestic Prod.	2892.9	3037.4	3180.5	3299.7	3329.0	3212.5	3148.7
(Memo: Annual Rate of Growth)	(7.8)	(5.0)	(4.7)	(3.7)	(0.9)	(-3.5)	(-2.0)
Plus: Imports of Goods and NSF	576.9	602.0	557.2	509.2	490.1	371.8	296.7
Less: Exports of Goods and NSF	575.6	575.0	632.7	665.4	573.7	508.8	451.8
Domestic Expendit.	2894.2	3064.4	3105.0	3143.5	3245.4	3075.5	2993.6
Consumption	2398.5	2521.3	2632.6	2740.2	2791.5	2681.3	2630.6
Private	2186.2	2295.5	2392.8	2471.7	2511.2	2435.8	2392.0
Public	212.3	225.8	239.8	268.5	280.3	245.5	238.6
Investment	462.9	496.6	471.2	424.7	443.3	373.9	310.1
Private	335.0	372.6	326.2	252.3	212.4	211.8	172.6
Public	127.9	124.0	145.0	172.4	230.9	162.1	137.1
Stock Adjustment	32.8	46.5	1.2	21.4	10.6	20.3	52.9

1/ Preliminary.
2/ Estimated.

Sources: SIECA, Estadísticas Macroeconómicas, July 1981, p. 2; Central Bank and ROCAP estimates.

TABLE 2: GUATEMALA: BALANCE OF PAYMENTS, SELECTED YEARS
(Millions of US$)

	1970-73	1978	1979	1980	1981	1982 1/	1983 2/
Current Account Balance	- 13.8	- 262.2	- 196.4	- 176.4	- 564.7	- 371.1	- 238.3
Trade Balance	- 1.6	- 298.2	- 282.5	- 78.4	- 374.4	- 188.4	- 100.3
Exports, FOB	340.4	1092.4	1221.4	1519.8	1299.1	1,199.6	1090.7
Imports, CIF	-342.0	-1390.6	-1503.9	-1598.2	-1673.5	1388.0	1191.0
Services and Transfers, Net	- 12.2	36.0	86.1	- 98.0	- 190.3	- 182.7	- 188.0
Capital Account	59.3	339.0	162.0	- 161.0	216.0	- 14.8	288.3
Private, Net	51.4	236.5	41.9	- 323.0	- 58.3	- 289.5	105.5
Short-term, Net	3.1	82.2	- 102.5	- 461.0	- 221.6	- 363.9	79.4
Medium and Long-term, Net	48.3	154.3	144.4	138.0	163.3	74.4	26.1
Official and Banking Net	7.9	102.5	120.1	162.0	274.3	274.7	182.8
Short-term, Net	.3	7.5	.1	59.0	55.3	2.4	--
Medium and Long-term, Net	7.6	95.0	120.0	103.0	219.0	272.3	182.8
Errors and Omissions	- 7.0	- 0.8	7.4	18.4	- 0.3	- 7.6	
Change in Reserves (- is an increase)	- 38.5	- 76.0	27.0	319.0	349.0	49.1	- 50.0
Accumulation of Arears	--	--	--	--	--	344.4	--
(Net International Reserves) 3/	125.0	682.0	655.0	336.0	- 13.0	- 62.1	- 12.[illegible]
Total Merchandise Exports		1092.4	1221.4	1519.8	1299.1	1199.6	1090.7
Basic		682.4	715.4	740.0	568.0	--	--
of which, coffee		477.4	430.3	444.7	325.3	--	--
cotton		139.2	182.8	169.0	170.0	--	--
bananas		22.2	24.2	41.0	50.0	--	--
CACM		16.0	37.0	--	--	--	--
Rest of World		666.4	678.4	--	--	--	--
Manufactured 4/		410.0	506.0	780.0 2/	731.1 2/	--	--
CACM		239.0	275.0	--	--	--	--
Rest of World		171.0	231.0	--	--	--	--

1/ Preliminary.
2/ Estimated.
3/ Does not include arrears.
4/ Includes semi-processed beef and refined sugar.

Source: Central Bank, SIECA and ROCAP estimates.

The reversal in the terms of trade, which has affected the economies of all the CACM members, has also cut into Guatemala's manufactured exports to Central America. A shortage of hard currency debilitated operations in the Clearing House upon which the member countries depend to settle their trade balances within the CACM. The result was a contraction in Guatemala's regional trade which in 1979 accounted for 55% of all manufactured exports and about 10% of manufacturing production. In 1981, the volume of such trade declined by 12% in nominal terms (probably 20% in real terms) and in 1982 by another 16%.

Political violence in Guatemala --and throughout Central America generally-- has effectively halted the flow of foreign capital which played a vital part in financing growth in Guatemala in the 1960's and 1970's. Since the late 1970s, Guatemala has suffered serious domestic political violence from at least four armed insurgent groups. This violence, combined with the situation in Nicaragua and El Salvador, has tended to reinforce the decisions of foreign investors and foreign commercial banks to halt investment and not roll-over loans and short-term trade credits.

As economic growth first slowed and then turned negative in 1982, disequilibrium appeared in public sector finances and in the balance of payments, two developments that quickly aggravated the crisis and accelerated the pace of the economic decline. The Guatemalan government has traditionally taken a very conservative stance on the issue of public finances; consequently, Guatemala has not suffered the chronically high deficits that plague many developing countries. In 1978, there was a current surplus equalling 3% of GDP, an amount that financed almost the whole of public sector capital formation leaving an overall public sector deficit of only 1.1% of GDP.

After 1978, public finances began to deteriorate with falling revenues and rising expenditures. Declining domestic incomes and the falling value of international trade cut deeply into current revenues. Expenditures rose as the government attempted to counteract the general economic downturn by increasing public sector employment, and as work accelerated on public sector investment projects. As a result, current savings shrank and the overall deficit increased from 1.1% of GDP in 1978 to 7.4% in 1981.

TABLE 3: GUATEMALA: FINANCIAL OPERATIONS OF THE CENTRAL GOVERNMENT
1978-1983

($US Millions)

	1978	1979	1980	1981	1982	1983 1/
Current Account	193.2	135.5	93.2	13.0	19.8	-7.2
Revenues	660.7	668.3	747.3	740.6	729.8	693.8
Expenditures	467.5	532.8	654.1	727.6	710.0	701.0
Capital Account	- 261.5	- 313.2	- 461.7	- 650.6	-430.2	- 339.4
Revenues	4.4	2.1	0.7	1.8	1.3	0.6
Expenditures	265.9	315.3	462.4	652.4	431.5	340.0
Overall Balance	- 68.3	- 177.7	- 368.5	- 637.6	- 410.4	- 346.6
Ext. Financing, net	83.6	115.2	92.9	102.1	95.2	100.2
Dom. Financing, net	- 15.3	62.5	275.6	535.5	315.2	246.6
of which Central Bank Credit	(25.0)	(88.0)	(241.0)	(400.0)	(178.0)	(--)
Memo Items						
Deficit as % of GDP	1.[illegible]	2.6	4.7	7.4	4.7	3.8
Yearend disbursement and undisbursed public sector debt	783.5	837.1	882.3	1041.1	--	--
GDP Deflator	5.5	8.6	10.0	9.0	5.8	6.8

Source: Central Bank and Ministry of Finance

1/ Preliminary

The accounts of the Guatemalan financial system reveal the monetary impact of this expansion in public sector deficits. Domestic assets of the consolidated banking system increased by 140% between 1978 and 1981. Credit to the private sector increased 65% between these two years, while net credit to the public sector increased more than 500%.

This rapid growth in domestic credit in the face of sluggish export performance was inconsistent with equilibrium in the balance of payments. The deficit in Guatemala's balance of payments grew from $76 million in 1978 to $349 million in 1981. Deficits of this magnitude quickly eroded Guatemala's international reserves from some $700 million in 1978 to practically zero in 1981 (see Table 2).

3. Implications of the Crisis

One important casualty of the economic downturn has been the private sector. As business firms cut back on capital improvement in reponse to the downturn, fixed investment in the private sector shrank from 12% of GDP in 1978 to 7% in 1982. Additionally, the explosive growth in banking system credit to the public sector has gradually reduced the availability of real short-term credit to the private sector. In 1979, total credit from the banking system to the private sector increased by 20% (10% in real terms), in 1980 by another 20% (4% in real terms), in 1981 by 16% (about 4% in real terms) and in 1982 by about 7% (0% in real terms). These events have not only caused a supply side shock to business activity and have delayed capital replacement, but the absence of such investment will make it difficult to restructure the productive base to meet increased export demand when it comes.

The cost of the economic downturn has been heaviest in terms of unemployment and underemployment at a time when it is politically dangerous to allow such developments to take place. Between 1979 and 1983 there was little real growth in the Guatemalan economy. During the same period of time, 265,000 people have joined the labor force. Slow economic growth has meant that these people have had to join the pool of open unemployment in the modern sector and the already vast pool of underemployed in the urban and rural traditional sectors.

Guatemala has been spared high rates of domestic inflation. As measured by the GDP deflator, inflation declined from 10% in 1980 to 6.8% in 1983 or at about the same pace as world inflation (see Table 3). Two factors kept the expansion in domestic credit required to finance public sector expenditures from putting upward pressure on the price level. First, large foreign reserves allowed rapid increases in public sector expenditures without putting excess demand on domestic resources. Second, when reserves had almost disappeared, the government chose to maintain fixed parity with the dollar, thus forcing domestic adjustment to fall on unemployment rather than inflation.

4. The IMF-Sponsored Stabilization Program

In 1982, Guatemalan authorities attempted to check the financial deterioration in the internal and external accounts of the economy. An adjustment program to be supported by a one-year IMF stand-by arrangement was structured for 1982. The objectives of the program were to reduce the public sector deficit to 4% of GDP and limit the loss in net international reserves to no more than $50 million. Central government current expenditures were cut and many investment projects that had not reached completion were cancelled. As a result, more than $200 million was trimmed from the deficit, reducing it to 4.7% of GDP --an improvement, but still above program targets.

The balance of payments continued to worsen in 1982. While the current account improved because of a drop in imports reflecting the decline in economic activity, this improvement was offset by a further deterioration in the capital account including some capital flight. When Guatemala began to fall behind in payments for imports, foreign suppliers and banks cut off most of Guatemala's normal trade financing. Consequently, in 1982, Guatemala registered a $393 million deficit in the balance of payments including $344 million in payments arrears that were carried into 1983 as the so-called presa.

When the 1982 IMF program expired in November 1982, the Guatemalan authorities instituted tightened foreign exchange controls and a quota system for imports. Administrative delays in processing foreign exchange applications were lengthened, and more foreign exchange transactions were shifted to the illegal, but officially encouraged, parallel market.

In 1983 the government negotiated a new stand-by agreement with the IMF that covered a period of 16 months, September 1983 through the end of 1984. The key features of the new program were a further reduction in the public sector deficit through both expenditure restraint and a new tax system and an improvement of the financial position of the Central Bank through both an orderly cancellation of the presa and recourse to medium-term foreign borrowing to replace private lines of credit that were withdrawn in 1982.

The heart of the fiscal program was a new value-added tax to replace a cascading stamp tax on domestic sales. The value-added tax applies to all goods and services sold in the domestic market with a host of exceptions.

The new tax had little effect on public sector finances in 1983. It was instituted too late in the year and, to make matters worse, the government of General Mejia reduced the level of the tax from 10% to 7% shortly after coming to power in August 1983. Simultaneously the current account of the central government moved from a small surplus in 1982 to a $7 million deficit in 1983. Any increase in revenues from the value-added tax was overshadowed by a continued decline in income tax and foreign trade tax revenues. The overall deficit of the central government improved in 1983 --and Central Bank credit to the central government was kept within program limits-- due to another sharp cut in capital expenditures. The overall deficit of the central government was reduced in 1983 to 3.8% of GDP, within the program target.

There was a modest improvement in Guatemala's external accounts in 1983. The exchange control measures, as well as the continued decline in economic activity, reduced imports by almost $200 million from the 1982 level. The capital account moved into surplus and net reserves increased by $50 million.

C. Structural Problmes

1. Poverty

What immediately strikes the observer of the Guatemalan economy is the wealth of the country in per capita GDP terms on one hand and the extent of poverty affecting most of its population on the other. In 1983 Guatemala arguably had the highest per capita GDP in the CACM (after Costa Rica's massive devaluation in 1982), but by any measure its population overall is among the most ill-fed, uneducated and unhealthy in Central America, or in Latin America for that matter. Adult literacy at 48% in 1980 is 14 percentage points below El Salvador, the poorest country in Central America, and only slightly more than half that of Costa Rica (see Table 4). The incidence of malnutrition in pre-schoolers was over twice that of Costa Rica. The infant mortality rate among the indigenous population in the Altiplano region in 1980 is estimated at 160 per 1,000 live births, a rate twice the average for Latin America and comparable to rates in Haiti, Bolivia and Zaire.

The explanation of this dichotomy between wealth and poverty lies, of course, in the distribution of that wealth. Guatemala has the worst income distribution in Central America. Income distribution data for 1970 -- unfortunately the latest data available -- shows that in Guatemala the bottom 50% of the population earned only 13% of total income while the wealthiest 5% earned the greatest share of total GDP, greater than any of the other countries of Central America (see Table 4).

To answer the question why wealth in Guatemala is so badly distributed is to analyze the roots of poverty in the country. Even though real per capita GDP has increased 2 to 3 percent annually from 1960 to 1978, this growth has not reached the majority of the population. Not only does Guatemala lack the modern redistributive mechanisms of industrialized nations to spread broadly the benefits of growth, historically Guatemala has lacked the commitment to investment in human capital necessary to uplift its people and build for their future. One indicator of the lack of commitment is the percentage of the GDP spent on education. That figure in 1979 was 1.7%, one-half of what El Salvador and Honduras spent and one-fifth of what Costa Rica spent (see Table 5).

TABLE 4: CENTRAL AMERICA: PATTERNS OF INCOME DISTRIBUTION, 1970

	I Lowest 50%	II Next 30%	III Next 15%	IV Highest 5%
Guatemala	13%	24%	28%	35%
El Salvador	16%	24%	33%	27%
Honduras	13%	24%	30%	33%
Nicaragua	15%	25%	32%	28%
Costa Rica	18%	26%	27%	29%
CA	13%	26%	30%	31%

Source: IDB, SIECA, El Desarrollo Integrado de Centroamerica en la Presente Decada, P. 28.

TABLE 5: CENTRAL AMERICA: COMPARATIVE EDUCATION INDICATORS

	Guatemala	Honduras	El Salvador	Nicaragua	Costa Rica
- Adult Literacy Rate	48.0%	60.0%	62.0%	90.0%	90.0%
- Percent GNP devoted to education	1.7%	3.5%	3.4%	3.0%	8.4%
- Primary enrollment ratio	69.0%	89.0%	82.0%	85.0%	93.0%
- Completion rate for primary school	--	30.0%	32.0%	24.0%	77.0%
- Percent of total central government expenditure on education	12.6%	14.3%	23.1%	14.0%	31.1%

Source: World Bank.

According to the 1979 Census, only 47% of the population over ten years old belongs to the labor force,[1/] one of the lowest rates in Latin America. Lack of opportunity rather lack of willingness to work accounts for this low rate of economic participation.

Not all of the work force is fully employed and estimates of unemployment and underemployment are crucial in determining the actual extent of economic participation among the population. Reliable data on unemployment and underemployment are not readily available in Guatemala, but using the census it is possible to compute the percentage of open unemployment and the percentage of those working less than 40 hours weekly and those earning less than the minimum wage -- two acceptable measures for underemployment. Although the number of those unemployed in Guatemala is not large -- 1.5% of the work force in the rural areas and 3.3% in the urban areas -- the extent of underemployment is staggering. Including those who work less than 40 hours weekly and those who work 40 hours or more weekly but earn less than minimum wage, the pool of underemployed comes to a total of 41% in the urban areas and 50% in the rural areas. With the general economic decline that began in 1978, these numbers have undoubtedly grown worse. But in 1979 only 53% of the work force and 24% of the population over ten years was fully employed. Underemployment and low wages, simply put, are two of the principal factors explaining poverty in Guatemala. Redistribution measures alone are clearly not the answer as that would be nothing more than a means of socializing poverty. Sustained high levels of broad-based growth with equity are needed to break out of the poverty and underdevelopment afflicting Guatemala and its people.

1/ Data for the economically active population (EAP) in Guatemala reveals the extent of participation in all economic activity. This data is available through the National Census and is considered equivalent to the national work force. The EAP includes persons of both sexes, ten years of age or older who hold employment or who are seeking it. The EAP excludes persons ten years of age and over dedicated to non-remunerative activities and others who for whatever reason are economically inactive. The sum of both economically active and inactive population plus all those under ten years of age equals the total population.

TABLE 6: GUATEMALA: ECONOMICALLY ACTIVE POPULATION, 1964-79

	Total	Male	Female	Participation Rate Total	Participation Rate Male	Participation Rate Female
1964	1,339,887	1,176,105	163,782	46.3	80.4	11.4
1973	1,545,658	1,328,730	216,928	44.7	76.3	12.2
1979	2,182,817	1,733,598	449,219	46.9	75.5	19.0

Source: SEGEPLAN as published in W.B. draft report Table 1.3(B)
DIGESA, Encuesta Nacional de Ingresos y Gastos, 1979-81.

TABLE 7: GUATEMALA: UNEMPLOYMENT AND UNDEREMPLOYMENT, 1979

	Total	Urban	Rural
Open Unemployment 1/	2.2	3.3	1.5
Underemployment 1/	46.2	41.4	49.7
Working less than 40 hrs. weekly	17.6	17.6	17.7
Working 40 hrs. or more 2/ weekly but earning less than minimum wage	28.6	23.8	32.0
TOTAL	48.4	44.7	51.2

1/ Calculated as a percentage of the economically active population.
2/ The annual minimum wage was calculated on an 8 hrs. day, 6 days weekly for 52 weeks a year. For the rural areas this would be Q1,000 (Q3.20 per day) and for the urban areas Q1,170 (Q3.75 per day).

Source: Calculated from the Encuesta Nacional de Ingresos y Gastos Familiares, 1979-81, Dirección General de Estadística.

Guatemala conforms in many ways to the classic "vicious cycle of poverty" often featured in development studies. High illiteracy, poor health conditions and a low capital endowment per worker combined with underdeveloped and fragmented labor markets have led to low productivity and low wages in the nation's work force. These conditions -- to complete the cycle -- will not provide the high level of demand and savings that is necessary for the expansion of investment in the high productivity sectors of the economy.

For a successful attack on poverty the vicious cycle must be broken at various points. The economy's productive resources must be more rationally employed in agriculture and industry, and equally important, more resources must be devoted to improvement in the health and education of the work force. Recent IBRD and IDB country economic studies fully support this thesis, but to accomplish this, certain structural problems -- the subject of the following two sections -- must be overcome.

2. Agriculture

a. Background

In spite of the impressive rate of growth in industry since the formation of the CACM, agriculture is still the dominant productive sector of the Guatemalan economy. Even though its share of GDP had fallen since 1960, agriculture still claimed 26% of all economic activity in 1978. According to the latest census, 55% of the work force is engaged in agriculture and only 14% in manufacturing. In 1981 55% of total exports were accounted for by unprocessed and semi-processed agricultural goods. Even these figures understate the importance of agriculture to the Guatemalan economy, for much of industrial production and manufactured exports -- food products, wood products, furniture, and textiles -- has direct links to the agriculture sector.

About 54% of all farms in Guatemala, containing perhaps 80% of the rural population, consist of plots of 1.4 hectares or less. This is generally considered too small to generate enough subsistence and cash on-farm income for the basic needs of a rural family (5 or more people) without resorting to off-farm employment, usually as migrant laborers on South Coast plantations. This problem is most visible in the Altiplano region, the Indian heartland, which contains 46% of the Guatemala's population but only 19% of its soils capable of high to moderate yields. Heavy population pressures against a short supply of good land due to the rough and hilly terrain make agriculture a difficult enterprise in this area. The natural resource base and ecology of the region are increasingly strained. Only high-value, multi-cropping, labor-intensive systems offer the possibility of substantially increasing family incomes in the Altiplano.

At the other extreme, the South Coast contains only 15% of Guatemala's population, but 30% of its good soils. It is in this region that the large farms raising cattle and growing sugar cane and cotton for export are found.

TABLE 8: GUATEMALA: DISTRIBUTION BY FARM SIZE, 1979

	No. of Farms	Total Area (000 ha.)
Small Farms (.7 to 7 ha.)	468,368	678.6
Medium Farms (7 to 900 ha.)	62,686	2,598.5
Large Farms (900 and up ha.)	482	903.2
Total Guatemala	531,536	4,180.3

Source: Agricultural Census.

b. Structural Problems

One of the serious problems in Guatemalan agriculture is the gradual decline in the rate of growth in food production. In 1981, traditional export commodities accounted for 52% of agricultural production, food production accounted for only 31%. From 1967 to 1981 real growth in food production averaged 2.7% annually, about .3% below the population growth rate. But in recent years the growth rate in food production has declined, from 1975 to 1981 real growth in foodstuffs averaged only 1.4% annually, about 1.6% below the population growth rate.

The downward trend in food production, however, is not totally explainable by a fall in effective demand. Import figures for rice, corn and beans show some upward trend in the last half of the 1970's demonstrating that demand for foodstuffs has not declined significantly. The explanation for the sluggish growth in foodstuffs lies primarily in declining terms of trade and supply side constraints such as poor marketing systems, and storage facilities, high cost transportation and primitive agricultural technologies.

The problem is particularly acute in the Altiplano. In spite of the lower quality of its soils and the nature of its terrain (compared to lands on the South Coast), this area produces about 35% of the country's food crops. In this region the small farmer predominates and incentives for him to produce corn and bean staples for the market have eroded since the mid-1970's. The terms of trade for the Altiplano small farmer -- the relationship between the prices he receives for his output and the prices he must pay for goods and services produced in the urban areas -- has declined 32% since 1975. Furthermore, the government has done little to upgrade small farm technologies in the Altiplano or to improve the infrastructure of the region. However, conditions are highly favorable for labor intensive, exportable temperate climate fruit and vegetable crops.

If the downward trend in food production continues the Guatemalan economy will face several problems. First, there will be a growing dependence on imported foodstuffs placing an added burden on the balance of payments. Second, the economic mainstay of the small farmer will gradually disappear and in the absence of alternative crops his real income will continue to fall.

A second structural problem is the large percentage of good soils devoted to plantation agriculture systems for the production of export crops whose future in international markets is uncertain at least for the rest of this decade. As we have seen, the richest agricultural area, the South coast, is used almost entirely for traditional export crops. Sugar cane, for example, occupies 52% of the soils capable of high to moderate yields in this region. Labor productivity is much lower than on efficiently operated small farms and profits are highly concentrated. Smallholder coffee farmers are of limited importance compared to Costa Rica or Colombia where such resident owner-operators form a strong and productive rural middle class.

A third problem is that the North, containing 30% of the country's good soils, is, for all practical purposes, underdeveloped. Only 9% of the total population lives there owing to the absence of roads, communication, and other infrastructure necessary for development.

TABLE 9: GUATEMALA: AGRICULTURAL PRODUCTION BY PRINCIPAL CROP CATEGORIES, 1967-81

(in 1958 US$)

	1967	1970	1975	1981	Annual Rate of Change 1967-81 %	Annual Rate of Change 1975-81 %
Total Crops	287.3	320.3	452.8	523.9	4.4	2.5
Export Crops	142.1	162.9	233.5	274.4	4.8	2.7
Crops for Local Consumption	112.3	121.2	149.3	161.9	2.7	1.4
Industrial Raw Materials	32.9	36.1	70.1	87.6	7.3	3.9

Source: Central Bank, Memoria.

The key to increasing growth in Guatemalan agriculture is to improve the allocation of resources in the sector. Food production must be increased through improved technologies in the Altiplano and better incentives to farmers. There must be incentives for diversification in commercial agriculture, large scale and small scale, to include greater production in product areas where Guatemala would encounter more dynamic world markets. Such product areas include fruits, vegetables and rubber, products which could not only be exported in crude or semi-processed form, but could serve as the basis for a larger food processing industry. Lastly, greater efforts should be made to open up the unused land in the north of the country to agriculture production.

TABLE 11: GUATEMALA: TERMS OF TRADE FOR THE TYPICAL ALTIPLANO SMALL FARMER, 1975-81

	1975	1976	1977	1978	1979	1980	1981
Producer Prices 1/	100	89	110	120	123	NA	140
Consumer Price Index	100	123	138	149	166	184	205
Terms of Trade	100	72	80	81	74	-	68

1/ Based on a typical production basket of a small farmer in the Altiplano: 60% corn, 30% beans, 10% wheat.

Source: Calculated from Central Bank and World Bank estimates as published in draft W.B. report, P. 40.

TABLE 10: GUATEMALA: LAND USE IN AGRICULTURE

	Total Area (000 ha.)	1980 Population (000)	1st. & 2nd. Degree and Multiple Use Soils (000 ha.)	1979 Area Devoted to Food Crops 1/ (000 ha.)	1979 Area Devoted to Sugar (000 ha.)
All Guatemala	10,809.2	6,043.4	2,956.2	575.2	
Altiplano	2,806.7	3,606.7	572.3	193.7	
Chimaltenango					
Sacatepequez					
Huehuetenango					
Quezaltenango					
San Marcos					
Solola					
Totonicapan					
Guatemala					
South Coast	1,170.5	921.0	847.8	108.9	440.0
Retalhuleu					
Suchitepequez					
Escuintla					
Santa Rosa					
Oriente	2,065.6	947.3	652.2	115.6	
Jalapa					
Jutiapa					
Chiquimula					
El Progreso					
Zacapa					
Izabal					
North	4,766.4	568.4	883.9	157.0	
Peten					
Alta Verapaz					
Baja Verapaz					

1/Includes potatoes, rice, wheat, beans and corn.

Source: 1979 Census.

3. Industry

a. Background

Manufacturing in Guatemala grew very rapidly under the stimulus of the CACM. From 1960 to 1970, the first decade of the Common Market, real growth in manufacturing averaged 7.9% annually, about 2.5% higher than GDP. Manufacturing in these years was a true leading sector and its participation in GDP grew from 12.8% in 1960 to 16% in 1970.

Guatemalan manufacturing lost its leading sector status around 1970. At about that time the dynamic from import substitution was spent and manufacturing grew in response only to domestic and regional demand. From 1970 to 1978 growth averaged 6.1%, exactly equal to that of GDP. With the onset of the recession in 1978 growth dropped to 3% a year through 1981. Manufacturing's participation in GDP stood in 1981 where it had in 1970, about 16%.

The structure of manufacturing in Guatemala has changed markedly since 1960. In that year the intermediate good sector accounted for 21% of total manufacturing production. By 1970, after annual growth rates 60% higher than rates for all manufacturing, intermediate goods claimed 27% of all manufacturing production. In this sector -- led by textiles, chemicals and non-metal minerals -- Guatemala has industries based on its natural resource endowment and consisting for the most part of labor intensive activities.

b. Structural Problems

The problem facing Guatemalan manufacturing lies in the structure of its exports, and the challenge facing Guatemalan manufacturers is to expand exports to extraregional markets by building upon the regional successes achieved since 1960. The existence of the CACM has been the real stimulus to industrial growth since 1960, but overall, the Common Market absorbed only 10% of manufacturing production in 1979. However in intermediate and capital goods, the dynamic sectors since 1960, the CACM absorbed about 25% of production. Without substantial growth in domestic and regional demand -- an unlikely event in the 1980's -- only new markets will provide the vehicle for developing manufacturing once again into a leading sector in the Guatemalan economy.

In fact, Guatemalan manufacturing has already begun to diversify its exports (see table 13). Since 1970, Guatemalan intermediate goods producers have increased their extraregional exports from $8.1 million

TABLE 12: GUATEMALA: GROWTH IN GROSS VALUE OF MANUFACTURING, 1960-81

(In Millions of 1958 US$)

	1960	1970	1978	1981	ANNUAL PERCENTAGE CHANGE 1960-70	1970-78	1978-81	1960-81
Consumer Goods	255.5	459.9	788.6	876.6	6.1	7.0	3.6	6.1
Food products, beverages and tobacco	188.1	325.1	543.8	587.3				
Clothing and Shoes	49.6	84.2	111.4	122.5				
Furniture	8.7	12.0	15.7	17.5				
Printing	3.7	7.6	9.1	10.7				
Leather Products	3.3	6.1	7.5	7.5				
Other	2.1	24.9	101.0	131.1				
Intermediate Goods	67.5	220.5	303.9	317.0	12.6	4.1	1.4	7.6
Textiles	28.4	78.5	93.5	99.1				
Wood Products	6.0	13.3	22.1	22.7				
Paper Products	1.3	11.0	17.1	17.6				
Rubber Products	2.5	9.2	14.7	17.0				
Chemicals	14.2	28.6	36.6	40.4				
Nonmetallic Minerals	11.1	21.2	43.2	44.9				
Basic Metals Metal Products	4.0	58.6	76.7	75.2				
Capital Goods	3.4	19.2	29.0	30.0	18.9	5.3	1.1	10.9
Nonelectric Machinery	.5	7.3	9.1	9.3				
Electrical Machinery	.5	7.3	11.5	11.8				
Transport Equipment	2.4	4.6	8.4	8.9				
Total Manufacturing	326.4	699.6	1121.5	1223.6	7.9	6.1	3.0	6.5

Source: SIECA, Compendio Estadistico, 1975 and 1981; Memoria del Banco de Guatemala, 1981.

TABLE 13: GUATEMALA: GROWTH IN TOTAL (Xt), REGIONAL (Xcacm) AND EXTRAREGIONAL (Xw) MANUFACTURED EXPORTS, 1970-79
(in millions of US$)

	1970			1979			Annual Rate of Change, 1970-79		
	Xt	Xcacm	Xw	Xt	Xcacm	Xw	Xt %	Xcacm %	Xw %
Consumer Goods	61.8	27.9	33.9	236.7	66.9	169.8	16.1	10.2	19.6
Food products, beverages and tobacco	47.5	18.4	29.1*	154.0	43.4	110.6*			
Clothing and Shoes	6.7	6.5	.2	14.9	14.0	.9			
Furniture	.3	.3	-	1.3	.8	.5			
Printing	.8	.8	-	2.3	2.2	.1			
Leather Products	.7	.7	-	2.2	1.1	1.1			
Other	5.8	1.2	4.6	62.0	5.4	56.6			
Intermediate Goods	69.1	61.0	8.1	249.3	188.8	60.5	15.3	13.4	25.0
Textiles	22.4	21.1	1.3	59.8	47.3	12.5			
Wood Products	2.2	1.2	1.0	3.5	1.2	2.3			
Paper Products	4.1	4.1	-	14.2	13.7	.5			
Rubber Products	4.7	4.7	-	14.1	11.7	2.4			
Chemicals	22.1	17.2	4.9	96.5	79.0	17.5			
Nonmetallic Minerals	6.2	6.2	-	21.9	19.4	2.5			
Metal Products	7.4	6.5	.9	39.3	16.5	22.8			
Capital Goods	5.9	5.6	.3	20.3	19.2	1.1	14.7	14.7	15.5
Nonelectric Machinery	.2	.2	-	1.0	.8	.2			
Electrical Machinery	5.1	4.8	.3	17.3	16.4	.9			
Transport Equipment	.6	.6	-	2.0	2.0	-			
Total Manufacturing	136.8	94.5	42.3	506.3	274.9	231.4	15.7	12.6	20.8

* Exports of food products outside the region include beef and sugar which, although classified as manufactures, are really semi-processed goods.

Source: SIECA, Compendio 1981.

to $60.5 million in 1979, a 25% annual increase. In 1970 exports of intermediate goods to extraregional markets amounted to 12% of all trade in manufactures; in 1979 that figure had grown to 24%. Three industries -- textiles, chemicals, and metal products -- have been responsible for this diversification.

Producers in the consumer goods sector have been less successful than their counterparts in the intermediate goods sector in exporting to extraregional markets. In 1970, 55% of total exports of consumer goods went outside the region; by 1979 that figure was 72%. But most of this trade consisted of semi-processed sugar and beer. Industries in which Guatemala should have a comparative advantage -- furniture, clothing, shoes, and leather products -- have done very poorly in extraregional markets.

The second structural problem in Guatemalan manufacturing is its geographical concentration (see Table 16). In 1980 [illegible]% of all firms in modern manufacturing (as distinguished from informal or cottage manufacturing) were located in the metropolitan area of Guatemala. Efforts to encourage the growth of industry in other areas of the country have met with little success due to limited industrial infrastructure outside Guatemala City. This makes more difficult the provision of off-farm employment opportunities in rural areas, and these job seekers are compelled to migrate to the capital.

This concentration of industry will also have a definite impact on incomes within Guatemala since wage employment will not be co-located with the largest pockets of underemployment and off-farm cash flows will not be able to be integrated readily into on-farm production and investment.

TABLE 14: GUATEMALA: RELATIONSHIP BETWEEN PRODUCTION AND TRADE IN MAJOR MANUFACTURING SECTORS, 1979

	Q 1/	Xt	Xcacm	Xw	Xt/Q	Xcacm/Q	Xw/Q
Consumer Goods	1976.0	237.0	67.0	170.0	...	.03	.09
Intermediate Goods	745.0	249.0	189.0	60.0	.33	.25	.08
Capital Goods	72.0	20.0	19.0	1.0	.28	.26	.02
Total	2793.0	506.0	275.0	231.0	.18	.10	.08

1/ Data on gross value of production in current prices is not available. Data in constant prices was converted to nominal terms using implicit prices calculated from national accounts data.

Source: SIECA, Compendio, 1981 and Table.

D. Outlook for the Guatemalan Economy During the Program Period

With the present political and economic conditions in Central America and in the world in mind, it is difficult to be sanguine about the long-term growth prospects of the Guatemalan economy. When Guatemala posted high growth rates in the past, it was riding the crest of a boom in commodity prices, was reaping the benefits of import substituting industrialization, or was experiencing some combination of both, and underlying all of this were two decades of relative political stability. Looking ahead, one is hard pressed to see these same conditions reappearing during the balance of this decade.

The most likely scenario is a modest rebound in the economy in 1984-85 followed by 3-3.5% growth in 1986-89. However, if the world economy demonstrates a robust period of growth and peace returns to the Central American region, an investment boom in industry and related non-traditional sectors would be possible. In such a case, Guatemala could return to high rates of economic growth by 1989.

TABLE 15: GUATEMALA: STRUCTURE OF GROSS DOMESTIC PRODUCT, SELECTED YEARS

	1960	1970	1978	1982
Primary Production	28.4	27.6	26.3	26.2
Agriculture	28.2	27.5	26.1	25.7
Mining	.2	.1	.2	.5
Secondary Production	15.5	18.9	21.4	20.9
Manufacturing	12.8	16.0	16.5	16.2
Construction	2.0	1.8	3.5	3.3
Public Utilities	.7	1.[illegible]	1.4	1.4
Tertiary Production	56.1	53.[illegible]	52.3	52.9
TOTAL	100.0	100.0	100.0	100.0

TABLE 15: GUATEMALA: GEOGRAPHICAL CONCENTRATION OF MANUFACTURING FIRMS 1/

1976-1980

	1976	1977	1978	1979	1980 2/
TOTAL	2,107	2,328	2,357	2,325	2,394
Guatemala	1,421	1,508	1,518	1,464	1,489
El Progreso	7	12	12	16	16
Sacatepéquez	37	80	79	72	73
Chimaltenango	19	30	35	35	38
Escuintla	57	71	68	72	78
Santa Rosa	162	158	169	181	185
Sololá	6	8	11	10	11
Totonicapán	11	13	14	13	14
Quezaltenango	111	118	114	117	119
Suchitepéquez	43	49	46	50	56
Retalhuleu	33	41	44	44	48
San Marcos	12	13	15	20	21
Huehuetenango	39	45	43	43	47
El Quiché	8	13	12	9	9
Baja Verapaz	8	9	12	13	14
Alta Verapaz	19	24	29	30	33
El Petén	13	13	11	11	12
Izabal	20	20	20	17	19
Zacapa	35	42	41	45	46
Chiquimula	10	13	14	11	12
Jalapa	13	2[illegible]	21	19	19
Jutiapa	23	27	29	33	35

1/ Firms with 5 or more workers, i.e., excludes the cottage or informal sector.

2/ Estimated.

Source: Dirección General de Estadística (Directorio Nacional de Establecimientos Industriales).

II. STRATEGY

A. Overview

The foregoing analysis demonstrates the basic development needs of Guatemala: return to a pattern of long term real economic growth emphasizing greater participation of the poor in the benefits of that growth, and an immediate need for a short-term stabilization program to meet the current severe economic recession. Achievement of these goals will depend upon the three key objectives which provide the framework for the U.S. assistance strategy for Guatemala over this planning period:

-- increased rural incomes and productivity;

-- reduced rate of population growth;

-- balance of payments equilibrium at higher growth levels.

The Strategy presented here is intended to stimulate broad-based, self-sustaining economic growth; growth with equity. Income redistribution *per se* is not a goal; however, growth alone will not alleviate the poverty found throughout Guatemala (per capita income for the poorest 50% of the population is $330 per annum based on the data in Tables 4 and [illegible].)[1/] The Strategy, therefore, is targeted on much greater participation in that growth by the rural poor; it combines the NBCCA objectives of economic growth and promotion of equity. Structural and policy changes will be necessary in many cases, and AID will continue the policy dialogue with the Government of Guatemala (GOG) on these issues in the context of both project and nonproject assistance.

The Strategy calls for the development of local institutional capacity, in both the public and private sectors, in order to make the development process self-sustaining. In addition, the Strategy includes specific activities designed to demonstrate alternative development approaches and technologies which can be continued or replicated with non-AID resources.

1/ -- 1984 GDP = Q9,900 million (based on Table [illegible], [illegible]% of the population receives 13% of the income; GDP for the poor is Q1,[illegible] million.

-- 1984 population = 7.8 million; (50% of the population = 3.8 million (NOTE: The GOG National Economic Planning Council estimates that 56.3% of the population lives in a state of extreme poverty.)

-- Thus: $\frac{Q1,287}{3.9}$ = Q330 per capita income of poor

The strategy objectives outlined here are consistent with the strategy in the previous CDSS, but greater emphasis is now being put on private sector-oriented approaches and on resource flows for balance of payments support. Basically unchanged development assistance objectives, thankfully, are supported by much higher DA levels. For the overall program, especially given the quantum increase in proposed levels growing out of the NBCCA recommendations, the national policy framework assumes greater importance; but now the USAID will be in a much better position to engage in a meaningful policy dialogue.

The current program in support of CDSS objectives which emphasize the Highlands is tightly focussed, highly targeted and is demonstrating significant successes toward meeting the Mission's key rural development objectives. Of ten active DA projects, nine are centered in the Highlands with significant overlap and direct impacts on the productivity and well being of the Indian population. Projects include: farm-to-market road construction and maintenance; small scale irrigation and terracing; crop diversification and fruit and vegetable marketing; rural enterprises; rural electrification; rural primary education, including bilingual and non-formal education; village water systems and primary health care promoters; and family planning services within a nationwide program. Institution building and transfer of technology are major components of almost all projects.

The following sections describe in greater detail the Mission's proposed Strategy for the FY 1985-89 planning period.

B. Increased Rural Incomes and Productivity

Increased rural incomes and productivity, principally through higher agricultural productivity, will be the major focus of U.S. assistance efforts over this planning period. The rural areas have significant untapped development potential; that is also where the people and the greatest poverty are. The census of 1980 indicates that 66% of the Guatemalan population is classified as rural and that 72% of the rural population is occupied principally in agriculture. Even these statistics understate the rural nature of the country since the definition of "urban" includes all municipal capitals (county seats), most of which are little more than small agricultural market towns.

1. Agriculture

Of the four major agricultural zones described in Section I -- the South Coast dominated by large farms oriented toward export crops, the eastern region, the under utilized northern areas, and the densely populated Western Highlands -- the last mentioned is the most important to the Strategy.

The Western Highlands, the Indian heartland of Guatemala, contains about 46% of the total population (67% of the rural population). It is also the poorest, with a population density of 191 persons per square kilometer and only 19% of the good lands (0.2 acres per person). A 1982 study[1/] estimated that 91% of the people in the Western Highlands had family (five or more people) incomes of less than $2,400 annually. More than half these families earned less than $1,200 annually. Subsistence level farming (mainly in the traditional crops of corn and beans) remains their primary occupation despite the fact that most farms have been subdivided to the point that they are no longer capable of supporting a family within present technology limits.

However, the Altiplano is an area well suited by soils and climate to the profitable production of temperate fruits and vegetables. As such, it is clearly not meeting its productive potential. The Strategy will attempt to introduce new technologies and cash crops together with other appropriate market mechanisms to raise productivity and incomes.

USAID will emphasize the small commercial and potentially commercial farmers and will work on both technological innovation and infrastructure and marketing improvements necessary to raise productivity and incomes. The geographic focus will be on the high potential Western Highlands in order to impact the greatest number of small farmers and to reach the areas of greatest poverty, however, this focus will not be exclusive of effective interventions that can be carried out in other areas. The Franja Transversal del Norte (FTN), the Eastern Highlands and small farmer pockets on the South Coast will be included. These farmers are operators of small businesses -- this is the private sector.

1/ AID financed-study by Centro de Consultoría, S. A. (CECONSA)

a. Improvement in the Existing Resource Base

The Strategy will include activities to improve the existing resource base such as terracing, small-scale irrigation, access roads, forestry management and diversification of output. Current efforts in these areas are showing a high rate of return for development dollar invested and are having a positive impact on farm family income. It will also include efforts to expand ownership of the resource base through a voluntary, private sector-oriented land marketing program which will help to create a Land Bank. The Land Bank would provide long-term financing through the banking system for purchase by small farmers of land assets on a "willing seller-willing buyer" basis. In further efforts to deal with the critical land tenure issue, the Mission would propose continuation of support for the colonization of the FTN (settlement, basic infrastructure and necessary services).

b. Efficiency in the Use of Available Resources

Since the ability of farmers to increase income is dependent upon efficiencies in the utilization of resources as well as upon improvement in the resource base, another important aspect of the Strategy will be increased efficiency in the application of available resources including technologies appropriate for the Western Highlands, the FTN or other agricultural areas. The Strategy, therefore, will include applied research and development of technologies appropriate to farm and farm-support production for the rural areas, especially those that are related to farming alternatives which offer greater opportunities for more intensive use of labor and higher returns per unit of land employed. The land markets program is in large part designed to increase the intensity of land use in order to raise productivity levels.

The GOG will be expected to place greater emphasis on agricultural research and the development and application of technology utilizing both public and private sectors. The GOG must also encourage and support the formation of private sector organizations including cooperatives through which credit and other inputs can be provided and marketing of production takes place. In the coming year USAID will define this higher level of effort by the GOG more specifically in terms of budget, personnel levels and program emphases.

c. Improvements in the Agribusiness System

With the view that agriculture is an integrated production and marketing system, increased productivity cannot be achieved without sufficient attention being paid to agribusiness development: processing and marketing, especially nontraditional export crops. In Guatemala, this is an activity carried out primarily by the private sector. Thus, agribusiness development presents another opportunity for USAID programs to work through and support private sector mechanisms which directly affect rural development.

The current system as it applies to small-scale farmers is characterized by: (1) fragmented small producer marketing efforts, (2) poor linkages between growers and processors, and (3) high product losses. The USAID Strategy, therefore, calls for programs which will support cooperative production efforts, improve marketing linkages and provide financing for private sector agribusiness investments. Related transportation systems will also be an area of attention, especially the construction and maintenance of access roads ("farm-to-market") as a critical element in providing market access for raising cash income levels. A third area of interest will be storage and handling facilities both small-farm scale and larger, more sophisticated facilities which will allow more flexibility in the marketing of certain farm products, especially perishables. Cooperative development programs will be needed to create forward linkages for farmers' production efforts.

2. Human Resources

Efficiencies in production are also dependent on the quality of human resources. This case holds true in both the agricultural and industrial sectors although the Strategy's primary impact is centered on the agriculture/rural target group over this planning time frame.

a. Health

> "Economic growth and human capital development are closely related; sustained growth cannot be achieved without at least a minimally trained, healthy population. Reduced mortality through improved health is critical to improving productivity in general, and agricultural output in particular" (AID Policy Paper on Health Assistance).

Overall health services coverage in Guatemala is very limited, less than 5% of the population has access to private medical care, about 30% has access to Ministry of Health (MOH) services and at least 50% is medically underserved. The leading causes of mortality and morbidity are enteric diarrhea and respiratory diseases which together are responsible for 50% of deaths. Both are preventable given adequate sanitation, potable water and shelter. In 1980 only 28% of rural Guatemalans had access to potable water. The infant mortality rate for the indigenous population in the Highlands is estimated to be 160 per 1,000, far above the Latin American mean or even the Guatemalan national mean. Average life expectancy for the Indian population is only 44 years. Significant institutional deficiencies in both human resources and organization hamper the ability of the MOH to provide an effective and efficient health delivery system. These deficiencies are particularly apparent at the lower end of the MOH institutional structure. Nor has the private sector yet been sufficiently motivated to work in the rural areas.

Accordingly, the USAID's program in health is designed to bring about a reorientation of the rural health system by strengthening appropriate segments of the public health sector (the MOH) and the private sector. This program has two essential approaches. The first is to reorient the MOH to a role of primary health care rather than medical care. The second is to motivate and develop the capacity of the private sector to deliver basic medical care to the medically underserved.

Under the former approach the USAID is working with the MOH to help them decrease the provision of expensive medical care and increase the emphasis on health measures which impact positively across a wide segment of the population. The USAID program will continue to improve the institutional capacity of the GOG to carry out community level projects in potable water and environmental sanitation and to provide primary health services with an emphasis on preventive care. Special attention will be given to the training and development of the human resources needed to carry out an extensive rural outreach system.

With the second approach USAID plans to establish a private sector mechanism for providing effective primary health care to rural areas on a fee for services basis. This is in contrast to the current GOG policy to provide "free" medical care to rural areas, even though the MOH does not and will not at any time in the near future have enough funding to provide for even complete basic medical care in the rural areas. A USAID pilot program will attempt to develop the means of providing minimum health care at a price sufficient to motivate the private sector and still be within the financial resources of the medically underserved.

The low nutrition level of the rural population is a multi-sectoral problem which is a function of income, availability of preventive health services, environmental sanitation, family education and population growth. Accordingly, USAID initiatives in the area of nutrition form an integral part of a number of the proposed activities. For example, nutrition education will be a major element of the medical auxiliaries' mandate under the GOG activities, and nutrition information will be included in the non-formal education programs. The continuing emphasis on rural water supplies is also designed to reduce the high rates of diarrheal disease and thereby address the malnutrition problem.

The direct supply of P.L. 480, Title II resources will supplement the GOG's national nutrition policy which utilizes locally-produced foods for supplemental feeding of the "at risk" population. In 1978, the GOG assumed complete responsibility for the school feeding program, allowing CARE and Catholic Relief Services (CRS), the two PVO's involved in P.L. 480, Title II, to focus on Maternal-Child Health Care programs and Food for Work projects. Between CARE and CRS, almost one-quarter of a million people are benefitted. In addition, CARE has organized a Food for Work project involving Peace Corps, the Ministry of Agriculture and the rural communities in reforestation. CARE is also involved in supplemental feeding programs in the colonization areas using P.L. 480 to support families during the start-up time until their own crops can be harvested. CRS uses Food for Work to build access roads and other community projects. These activities should be expanded during the planning period.

b. Education

Basic education and related skills training (non-formal education) contribute directly to agricultural development, lower fertility and increased health and nutritional status. The facts in Guatemala are that 48% of the population is illiterate and only 25% of the population has completed 1-3 years of schooling.

> "Agricultural productivity improves as farmers acquire basic education and they become both willing and able to adapt their traditional methods of farming to new techniques, to obtain and use information from extension systems, to use inputs efficiently, and to supplement farm income with other employment." (AID Policy Paper on Basic Education and Technical Training.)

World Bank studies have also shown a direct link between educational level and increased human productivity. These studies indicate that potential lifetime earnings for a person who has successfully completed an equivalent fourth-grade education will be double that of an illiterate with no education but living under otherwise similar circumstances.1/

Recent figures provide a deeply disturbing picture of the educational situation: 66% of all children in the 7-14 year-old age group live in rural areas but two thirds of them do not attend school. In the Highlands, less than 50% of the Indian population 7 to 14 years is even enrolled in school at all. At the secondary school level, nationwide, only 12% of all youth in the 15 to 20 year-old age group attended high school or vocational school. Of students entering 1st grade 92% do not complete 6th grade. Dramatic improvements in the "success rate" in rural primary education are essential to national development.

The predominance of adult illiteracy, as well as the large number of rural children with limited or no educational opportunities, creates special problems for the implementation of developmental programs focused on rural areas. The need for rural non-formal education programs is increasingly apparent as the GOG tries to reach small farmers with agricultural information.

1/ Primary Schooling and Economic Development: World Bank Staff Working Paper No 399.

In addition to these problems, basic education attempts in Guatemala are frustrated by the linguistic barrier. The extremely high drop-out rate and failure rate in Indian areas is due principally to the fact that students are taught an irrelevant curriculum in a language (Spanish) almost totally foreign to them.

Following with the basic AID policy for the education sector, applicable where less than two-thirds of the eligible age group are completing at least four years of primary school, the strategy during this planning period calls for assistance in making the basic education program effective in supporting economic and social development objectives. Emphasis will be on rural primary education with special attention directed at the bilingual education program to both improve and expand its coverage among monolingual Indian children. A realistic goal wi[illegible] 80% primary enrollment by 1990 requiring a 5% annual increase in enrollment over the five year planning period. USAID plans to reach 50% of Indian children currently enrolled in school with bilingual programs over the planning period, with higher achievement indicators measuring impact. The other area of concentration will be the management and planning of primary education programs by the Ministry of Education (MOE) where assistance will focus heavily on developing the human resources of the MOE itself (training of teachers and administrative personnel) and further development of relevant teaching materials and curricula.

Non-formal education efforts will continue to occupy a place of importance in the USAID program over the next several years. Non-formal education has been proven to be an effective means of upgrading human resources in tradition-bound rural areas. Plans are to expand the coverage of the current non-formal education program to all Departments with a predominantly Indian population.

USAID will work closely with MOE officials to develop and establish a national policy on education for Guatemala. Of priority concern will be the roles assigned to bilingual and non-formal programs within an overall education policy. The USAID will also work to ensure that a commitment to comprehensive planning and administration is contained within that policy. Most importantly, USAID will seek agreement on a sharply higher budget level for education remembering that the 1.7% of GDP spent on education is the lowest percentage in Central America.

While USAID will concentrate on improving the efficiency of the education system within available resources, close coordination with other donors will encourage expansion of those resources. For example, both the Inter-American Developmment Bank (IDB) and the World Bank (IBRD) are programming assistance to construct more of the satellite schools under a system developed here in prior USAID projects and to build up the system for developing, printing and distributing textbooks, long an area of AID work.

3. Institutional Development

While higher rural income levels is an objective built upon the private sector, certain public sector institutions will play critical roles in its achievement. As discussed earlier, higher levels of public sector social overhead investment in such supporting areas as schools, roads and health care are needed. For example, within the agricultural sector the extension services of DIGESA will be important in the dissemination of technologies developed and adapted by ICTA, the agricultural research institute. The Strategy recognizes the need to strengthen institutions of this nature and calls for USAID projects which will improve the planning, management and evaluation capabilities of public sector organizations with emphasis on development of the necessary linkages among farmers, extension service and research institute. Therefore, institution building will be an integral part of all activities undertaken over this planning period.

C. Slowdown in the Rate of Population Growth

As stated in the AID Policy Paper on Population Assistance,

> "Continued high rates of population growth significantly increase the cost and difficulty of achieving basic development objectives by imposing burdens on economies presently unable to provide sufficient goods and services for the growing population."

A rapidly increasing population beyond a country's capability to cope will cause a severe shortfall in programs designed to improve labor productivity and human resources. Such development programs can be highly effective in accomplishing numerical results within a specific target group, but their overall impact may be little or nothing when superimposed over a too-rapidly expanding population base.

Guatemala enjoyed real per capita economic growth over the two preceding decades. Despite high population growth rates, real GDP grew at even higher rates. That situation has changed. Real economic growth has declined into negative figures which, coupled with the official population growth rate of 3.0% (some estimates are as high as 3.2%), has greatly reduced per capita income. For the rural poor the situation is worse, as they have shared little in the economic growth of the past. If the 3.0% growth rate is not reduced, Guatemala will have almost 12 million people by the year 2000. Approximately 48% of those people will live in the Altiplano, a 70% increase for an already heavily populated region. For there to be realistic hope of stable, self-sustaining economic growth with equity by the end of this century, efforts to reduce the rate of population growth must play an integral part in the Strategy.

Guatemala may, however, be entering the "transition period" since births per thousand as well as deaths per thousand of the population are falling, albeit not at equal rates. If the births per thousand rate continues to decline the picture will not be quite as overwhelming by the year 2000. This slightly favorable change in prospects must be intensified through continued USAID emphasis on family planning programs, especially with private organizations.

USAID will continue discussions at the highest levels of the public and private sectors on the impact of population growth on the economy and resources of the country by the year 2000. During the planning period, USAID will encourage a more active role by public sector institutions as participants in family planning programs, with a GOG announcement of an acceptable national population policy as a condition for continued funding for public sector family planning program. The GOG continues to be reluctant to establish a clear family planning policy and to back it up with budgetary resources. The plan, however, should focus implementation in the hands of the private sector which is better able to deliver the necessary services. Government's role should be to provide an environment in which these private sector organizations can effectively expand their coverage. The Ministry of Health, for example, should assure that all rural health personnel -- doctors through promoters -- understand the need for limiting population growth and receive adequate training in how it can be done so as to provide advice and services to the rural poor and referrals to appropriate private sector organizations.

The Strategy related to family planning as conceived by USAID will stress the voluntary nature of participation based on informed choice. The expansion of the availability of family planning services and information among the poor majority will encompass both the indigenous and ladino populations, with special emphasis on the indigenous population within the Western Highlands where birth rates are high and user rates low. Preliminary, but highly reliable, data from the Contraceptive Prevalence Survey of 1983 indicate a significant improvement in contraceptive user rates over the past five years. Overall usage among married women between 15-44 years of age increased from 18% to 25% since 1978. Nonetheless, the increase is almost wholly attributable to urban and rural ladino groups. Usage has not increased among the indigenous population at all, and clearly points to the need for greater effort to address the program to this population. Targets for the period of this CDSS are a 45% acceptance rate (all methods) for ladino married women of reproductive age and 20% of such women among the indigenous population.

As a means of promoting the desired expansion, USAID will continue to place priority on the establishment of a commercial retail sales (CRS) program making contraceptives available at affordable prices throughout Guatemala. This effort will be carried out through IPROFA, a private sector company financed under the existing family planning project.

TABLE 17: PERCENT OF CURRENTLY MARRIED WOMEN AGED 15-44 CURRENTLY USING CONTRACEPTIVES BY REGION/ETHNIC GROUP AND METHOD

Guatemala 1978 and 1983

Current Use and Method	TOTAL		Department of Guatemala		INTERIOR Ladino		INTERIOR Indigenous	
	1978	1983	1978	1983	1978	1983	1978	1983
Currently Using	18.1	24.9	40.4	48.9	21.6	28.7	4.0	4.2
Sterilization	6.3	11.2	12.9	17.9	8.2	14.7	1.1	2.0
Pills	5.4	4.5	9.5	9.2	7.4	4.7	1.2	1.1
IUDS	1.3	2.6	4.6	7.5	0.9	2.1	0.3	0.1
Rhythm	2.7	3.4	6.9	5.9	2.3	4.3	1.1	0.5
Condom	0.7	1.7	2.4	3.0	0.7	1.2	0.0	0.1
Others	1.7	2.0	4.1	5.4	2.1	1.7	0.3	0.4
Not Currently Using	81.8	75.1	59.5	51.1	78.4	71.3	96.1	95.8
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Number of Cases (Unweighted)	1,915	2,792	473	771	765	1,079	677	842

Source: Contraceptive Prevalence Survey, 1983 (Preliminary findings)
Center for Disease Control, Atlanta

D. Balance of Payments Equilibrium at Higher Growth Levels

The Government of Guatemala has reduced the current deficits in its balance of payments, and has reduced the deficit in the overall public sector in order to restore balance in the internal and external sectors of the economy. However, these balances have been brought about by severely constricting development potential. Financial stability will be achieved but at a level of growth unable to match the increase in population and provide for a more equitable distribution of the benefits of growth. A financial stabilization program for Guatemala, then, must provide assistance in maintaining financial stability but at higher levels of real growth. Restructuring of the economy is required and that restructuring will require external concessionary sources of financing.

The economic analysis in Section I indicates that under optimistic assumptions the effect on GDP of the traditional external sector could not, even at best, match population growth at 3.0% - 3.2% per annum and thereby maintain per capita income levels. An external balance sufficient to allow real growth of 3.2% or better necessitates a shift away from traditional exports into new markets and new products, as well as reversing net private capital outflows.

The macro-economic program objectives are to induce sufficient external resources to allow the economy to return to a real GDP growth that will arrest further declines and even provide for some moderate growth in per capita GDP. Return to a high growth period (5.5% or greater) such as the 1960's and 1970's is unlikely for the remainder of this decade. Traditional commodity exports which are the real engine of growth in the Guatemalan economy will face, according to the World Bank,[1/] average world market price increases of 6.8% annually. A 3.2% supply response to these increases will result in a 10% annual rise in export revenues -- half that experienced in the 1970's.

Accordingly, USAID projects a 3% annual real GDP growth rate through 1993. Over this period due account has been given to a very rapid rate of growth in the non-traditional export sector. With sizable private and

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1/ World Bank Half-Yearly Revision of Commodity Price Forecasts - June 1983 public investment in this sector, we assume a 25% nominal annual rate by 1988-89. Non-traditional exports will be growing from a very small base, however, and therefore their impact on overall economic growth will be relatively small and insufficient to drive GDP beyond 3% per year.

Under our low growth scenario, we estimate (see Table 20) that Guatemala will require $2,475 million in external financing to cover the balance of payments deficits during the first six critical years (FY 1984-89).

External assistance will be needed to provide the foreign exchange necessary to finance imports at a level sufficient to sustain a 3.0-3.5% growth in real GDP. The USAID Strategy calls for $160 million of this gap to be financed through ESF cash transfer loans and $80 million to be covered by P.L. 480, Title I loans.

TABLE 18: GUATEMALA: PROJECTIONS OF THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS UNDER TWO SCENARIOS, 1984-1989

($US Millions)

	Near Term		Long Term			
	1984	1985	1986	1987	1988	1989
A. Low Growth Scenario						
Nominal GDP 1/	9900	10755	11745	12820	14065	15435
Real GDP (in 1970 prices)	3200	3280	3380	3480	3600	3730
(% of real change)	(1.5)	(2.5)	(3.0)	(3.0)	(3.5)	(3.5)
Gross Domestic Investm.	1090	1185	1290	1410	1545	1700
Public 2/	300	325	350	385	420	465
Private 3/	790	860	940	1025	1125	1235
Trade Balance	-50	-160	-183	-210	-241	-289
Exports, FOB	1150	1390	1520	1662	1824	1995
Traditional 4/	730	803	883	972	1069	1175
CACM 5/	250	400	432	465	505	545
Non-traditional 6/	170	187	205	225	250	275
Imports, FOB 7/	-1200	-1550	-1703	-1872	-2065	-2284
Net Services 8/	-285	-248	-273	-301	333	-371
Net Transfers, private 9/	40	55	70	85	100	120
Current Account	-295	-353	-386	-426	-475	-540
B. High Growth Scenario						
Nominal GDP 1/	9900	10755	11965	13440	15240	17445
Real GDP (In 1970 prices)	3200	3280	3380	3515	3690	3915
(% real change)	(1.5)	(2.5)	(3.0)	(4.0)	(5.0)	(6.0)
Gross Domestic Investm.	1090	1525	2035	2284	2590	2965
Public 2/	300	325	600	672	762	872
Private 3/	790	1290	1435	1612	1828	1093
Trade Balance	-50	-260	-327	-428	-556	-725
Exports	1150	1390	1558	1752	1994	2275
Traditional 4/	730	803	883	972	1069	1175
CACM 5/	250	400	465	540	625	725
Non Traditional 6/	170	187	210	240	300	375
Imports, FOB 7/	1200	1650	1885	2180	2550	3000
Net Services 8/	-285	-273	-315	-369	-436	-522
Net Transfers, private 9/	40	55	70	85	100	120
Current Account	-295	-478	-572	-712	-894	-1127

Source: ROCAP estimates

Footnotes: see page 31

FOOTNOTES -- TABLE 18

1. Assumes 6% annual GDP deflator under low growth and 8% during 1986-89 under high.

2/ Assumes 3% of GDP under the low growth scenario and 5% of GDP during 1986-89 of the high growth scenario.

3/ Assumes 8% of GDP under the low growth scenario and 12% of GDP during 1985-88 of the high growth scenario.

4/ Assumes a 6.8% annual price increase (following the IBRD price projections) and a 3.2% volume increase annually for a total of 10% under both scenarios.

5/ Assumes that in both scenarios interregional trade is restored to the 1980 nominal level in 1985. Therefore, it expands by 8% annually under the low growth scenario (half the rate experienced in 1971-78) and 16% under the high growth scenario (the same rate experienced in 1971-78).

6/ Assumes a constant 10% growth thru 1989 under the low growth scenario. Under the high growth scenario, non-traditionals rate of growth rises moderately thru 1987 and then experiences a 25% rate of growth annually in 1988 and 1989.

7/ Assumes that under both scenarios there is an import rebound too close to the 1980 level, but is stronger under the high growth case. Therefore, imports under the low growth case expand by an elasticity of imports with respect to GDP of 1.1 and under the high growth case by 1.3.

8/ Assumes an improvement in 1985 due to an increase in tourism. Therefore, exports of services equal 10% of physical exports and imports of services equal 25% of physical imports. These numbers reflect historical rates, but could be conservative on the import side if Guatemala increases foreign borrowings.

9/ Assumes that net transfers achieve by 1989 the pre-crises level.

TABLE 19: GUATEMALA: PUBLIC SECTOR FINANCES UNDER TWO SCENARIOS - 1984-1989

($US Millions)

	Near Term		Long Term			
	1984	1985	1986	1987	1988	1989
A. Low Growth Scenario						
Nominal GDP 1/	9900	10755	11745	12820	14065	15435
Central Government current revenue 2/	890	1076	1175	1282	1407	1544
Current account surplus of the state enterprises 5/	50	54	60	65	70	78
Central Government current expenditures 4/	-792	-860	-1057	-1155	-1266	-1390
Interest on public sector debt 5/	-80	-97	-117	-154	-197	-247
Capital Revenues 6/	20	21	23	26	28	31
Capital Expenditures 7/	-300	-325	-350	-385	-420	-465
Overall Deficit	-212	-131	-266	-321	-378	-449
(% of GDP)	(2.1)	(1.2)	(2.3)	(2.5)	(2.7)	(2.9)
B. High Growth						
Nominal GDP 1/	9900	10755	11965	13440	15240	17445
Central Government current revenue 2/	890	1076	1197	1344	1524	1745
Current account of the public sector enterpr. 3/	50	54	60	67	76	87
Central Government current expenditures 4/	-792	-860	-1077	-1210	-1372	-1570
Interest on public debt 5/	-80	-97	--117	-161	-213	-279
Capital Revenues 6/	20	21	24	27	30	35
Capital Expenditures 7/	-300	-325	-600	-672	-762	-872
Overall Deficit	-212	-131	-513	-605	-717	-854
(% of GDP)	(2.1)	(1.2)	(4.3)	(4.5)	(4.9)	

Footnotes: see page 43

Source: ROCAP estimates.

FOOTNOTES -- TABLE 19

1/ See Footnote 1 on Table 18

2/ The new tax structure allows an increase from 8% of GDP in 1983 to 9% of GDP in 1984 and 10% of GDP in 1985-89.

3/ Assumes that the historical rate of .005% of GDP will prevail during 1984-87.

4/ Ssumes 8% of GDP in 1984 and 1985 (the historical rate). In 1986-89 it rises to 9% of GDP. This includes transfers to rest of the general government.

5/ Rises from .008% of GDP in 1984 to .016% of GDP in 1989 or, a doubling of the interest burden and the program period.

6/ Assumes a constant .002% of GDP, the historical average.

7/ See Table 18 footnote 2.

TABLE 20: GUATEMALA: FINANCIAL GAP UNDER TWO SCENARIOS 1984-1989

($US Millions)

	Near Term 1984	1985	Long Term 1986	1987	1988	1989	TOTAL 1984/89
A. Low Growth							
Current Account 1/	-295	-353	-386	-426	-475	-540	-2475
US Official, net 2/	15	50	40	40	50	53	250
Non-US Official 3/ and banking, net	160	175	195	215	235	260	1240
Private Flows 4/	-120	-128	-151	-171	-190	-225	-985
B. High Growth							
Current Account 1/	-295	-478	-572	-712	-894	-1127	-4078
US Official, net 2/	15	50	40	40	50	55	250
Non-US Official 3/ and banking, net	160	175	195	215	235	260	1240
Private Flows 4/	-120	-253	-337	-457	-609	-812	-2588

1/ See Table 18

2/ Disbursements anticipated under current planning levels.

3/ The 1983 level has been expanded by 10% annually.

4/ This is to be interpreted as a residual rather than an actual projection.

Source: ROCAP estimates.

These funds together with non-U.S. official and net private banking of $1,240 million will be expected to induce the balance of $985 million in private flows. Under ESF financing priority will be given to the foreign exchange costs of producers of non-traditional exports, particularly agro-industrial, while not neglecting the needs of the existing industrial capacity, which an IDB study has shown could in many cases be competitive outside the Central American Common Market (CACM). Local currency generations would be used in part to create domestic lines of credit for the export sector both industrial and agricultural. Other local currency generations would be used to increase agricultural production credit lines for small farmers. A portion of the Quetzales generated by the BOP support would also be utilized to cover the GOG counterpart for infrastructure projects necessary to develop the non-traditional export sector.

In the context of the entire U.S. assistance package but especially in conjunction with the balance of payments support, the USAID would look to the GOG to establish a clear set of national development priorities focussed on the rural poor. These priorities should be specified in a development plan based upon a doubling over five years of the percentage of GDP devoted to the development budget affecting the rural poor and backed by national budget decisions. The increased development spending could be financed by allocation of not less than 60% of all additional revenues generated by the revenue enhancement program recommended by the IMF and the World Bank. This revenue enhancement program could include the following:

-- increased reliance on direct taxation;

-- improved efficiency of revenue collections and reduced widespread tax evasion;

-- establishment of rational and fairly administered import duties on non-productive consumption.

-- increased value added tax (VAT), if necessary to achieve revenue targets.

-- shift from a specific to an ad-valorem basis for excise taxes.

Specific conditionality for balance of payments support would call for the following in the first 1-2 years of program assistance: Establishment of appropriate export incentives which could include relaxation of import controls, movement toward free convertibility, and mechanisms for streamlining the issuance of export licenses. The issue of devaluation has arisen frequently and is still a debatable issue, but the more persuasive view is a general consensus that there is no medium term justification for a devaluation. For example, the IMF chose other areas as being more important to improvement in the Guatemalan economy. Domestic inflation in Guatemala has risen in line with that of its major trading partners; consequently, on a purchasing power parity basis, there is doubt that the Quetzal is significantly overvalued. The premium that the U.S. dollar brings on the parallel market is indicative of a politically-induced short-term crisis in the capital account, a problem that devaluation would not solve. The existence of an illegal, but officially tolerated and even encouraged, parallel market absorbs some of the excess demand for dollars and thereby acts as a halfway house between fixed parity with the dollar and devaluation. Over the long term, the policy issue should not be devaluation, as such, but the abandonment of the fixed exchange rate mentality and the adoption of one that accepts periodic exchange rate adjustments to maintain export competitiveness in the face of changing conditions in the domestic and the world economy. If and when the balance of payments is considerably stronger on the basis of a much broader of a much broader export mix than now, the time would be appropriate to think about a break from parity with the U.S. dollar.

The regional assistance being proposed on the basis of the NBCCA including CCC credits, housing guaranties, trade guaranties, balance of payments support to other countries in the region and direct support to the CACM Monetary Fund to clear regional trade deficits will benefit Guatemala as well. The regional assistance program is an important element in revitalizing the Guatemalan industrial sector if reforms in the CACM directed at moving it to an export orientation are achieved.

E. Other Issues

1. Democratization

Throughout the planning period the Strategy calls for broadening the respect for basic human rights and a return to free elections as the means of establishing a democratic civilian government. The commitment to expanding the benefits of growth to include the rural inhabitants, especially the indigenous population, will be the key indicator of GOG interest in improving the well-being of the people.

USAID needs clearer policy guidance from AID/W in order to see to what extent AID-funded and managed programs will be developed in support of the democratization goal. Possible programs could be carried out to strengthen the judicial system, provide for exchanges among U.S. and Guatemalan political leaders or financial support for the electoral commission.

2. <u>Shelter</u>

The GOG's National Housing Plan, 1979-2000, estimates that the accumulated backlog of substandard units in 1979 was 360,000. In order to bring the existing backlog of sub-standard units up to minimum acceptable levels (including access to water and sanitary services) by end of this century, some 28,000 existing units a year must be upgraded. In addition, 52,000 new housing units must be built every year (21,000 urban, 31,000 rural) to accommodate the growing population.

The AID-financed Urban Poverty Study (March 1980) provides the basis for USAID's shelter program. During the planning period the Strategy calls for the use of HG and grant funds to assist in designing and implementing mechanisms to: (1) develop incentives, guarantees and procedures which will induce greater private sector involvement in the construction and financing of shelter programs; (2) attract savings and other funds available in the financial system so as to provide a more reliable source of funds for the low-income shelter program; and, (3) provide technical assistance and training to strengthen the capabilities of key institutions to promote and implement low-cost shelter programs, as well as to collaborate more effectively with each other and with private housing finance institutions.

It is expected that, as the measures to strengthen the housing finance system begin to take effect, the Strategy will concentrate on and emphasize the objectives of expanding formal shelter sector activity in secondary cities, market towns and small rural settlements. Such a Strategy will involve assistance to the housing cooperative movement, financing for the provision of individual or collective basic services such as water and waste control, small home improvement credit programs, and cooperative sites and services projects in rural towns. USAID's emphasis will be on secondary cities and cooperative shelter programs.

3. Private Voluntary Organizations

USAID/Guatemala has a long-standing relationship with private and voluntary agencies, both international and indigenous, operating in Guatemala. PVOs have carried out pilot activities to demonstrate the feasibility of new technologies as well as community development projects throughout the country. During the last decade, USAID/PVO partnerships have increased the economic development impact of PVO programs, discouraged long-term dependence on U.S Government financing, and insured the use of AID funds in support of AID's legislative mandate while providing flexibility to the PVOs so their unique capabilities are promoted.

In furtherance of the objectives of AID, as stated in the Policy Paper "AID Partnership in International Development with Private and Voluntary Organizations," the AID Mission is encouraging the re-entry of PVOs into the Highlands; strengthening the administrative capabilities of indigenous private and voluntary organizations, cooperatives, credit unions, family planning organizations, and other non-profit intermediaries; and expanding country program integration to address Guatemala's development priorities. Over the short-term the Mission has designed a PVO strategy to focus on AID's principal development objectives in Guatemala. While PVO activities can obviously have only a marginal effect on national economic growth, they can serve as a means of providing opportunities for greater participation of the poor in the development process. The objectives of PVO assistance are: (1) increased incomes and productivity, (2) improved availability of social services, such as health, education and shelter, and (3) expanded access to family planning services. While these objectives and PVO activities cover both the rural and urban poor throughout Guatemala, the Mission places particular emphasis on proposals for activities to be carried out in the Western Highlands. In addition to more immedate needs of displaced persons, priority will be given to those interventions which provide for a self-sustaining development process.

Increasing agricultural productivity will be a key area of U.S. assistance to PVOs over this planning period. The focus will be on small commercial or potentially commercial farmers. The strategy includes activities to improve the existing resource base and efforts to expand the resource base through schemes which will bring currently unproductive land under ownership willing and able to farm it. An additional aspect of USAID efforts through PVOs is to promote small- to medium-scale industry in areas outside of Guatemala City. Activities which provide skills training and otherwise enhance the employability of the poor are also considered important.

The USAID will support PVO programs in health to improve the sanitary environment of the rural poor and to expand the outreach and effectiveness of rural health care. PVO initiatives in the area of nutrition will be encouraged as an integral part of proposed activities. To address problems associated with the availability of educational opportunities, both formal education and skills training, PVO proposals will be encouraged. Efforts will continue in support of two interrelated family planning concepts, namely (1) that knowledge of contraceptive methods needs to be more widespread, and (2) that means of contraception should be widely available. The Mission plans to continue to support the indigenous PVO APROFAM, as a center of expertise, while encouraging activities of other PVOs in expanding access to family planning services.

4. Peace Corps

The security situation in Guatemala has limited the integration of USAID and Peace Corps activities. The Peace Corps has only recently reassigned a small number of volunteers to the Highlands areas that are USAID's focus of attention. In addition the Peace Corps' recruitment and programming cycle differs from USAID's planning to implementation cycle and this variance has created difficulties in incorporating volunteers in the achievement of joint AID/Peace Corps objectives.

However, some joint activities have been carried out, and both USAID and Peace Corps plan to do more. At present the Peace Corps has been participating with some PVOs on projects funded by the USAID through an OPG or P.L. 480, Title II assistance. The Peace Corps has worked on an integrated community development effort with Project Hope, a small family fish pond project with CARE and a reforestation food-for-work project with CARE. Also there has been close coordination between the USAID and Peace Corps on the small projects funded through USAID's Special Development Fund (SDF) and the Peace Corps' Special Development Activity Fund (SDAF).

In the future with the return of volunteers to the Highlands, it would be possible to utilize volunteers in non-formal education efforts; have volunteers promote and assist in the expansion of soil conservation, terracing, small scale irrigation and access roads and involve volunteers in improvements in rural health and sanitation. Volunteers could also be a valuable resource in the establishment of viable settlements in the colonization areas.

While efforts to integrate USAID and Peace Corps programs have been hampered by circumstances in Guatemala, USAID and Peace Corps have maintained a continuous liaison and review of activities to determine where such cooperation might be possible. That liaison will continue, and should volunteers return to USAID project areas, activities do exist where they can play a useful role.

III. RESOURCE REQUIREMENTS

The program strategy as elaborated in the previous sections details the need for returning Guatemala to a stable pattern of economic growth and increasing the coverage of the benefits of growth. USAID's planning levels, which represent the Approved Assistance Planning Levels (AAPLs), are $249.7 million in Development Assistance (DA) financing, $160.0 million in Economic Support Funds (ESF) and $107.0 million in Food for Peace (P.L. 480) programs.

This distribution of assistance reflects the priority attention that must be given to development of the rural areas. With a tradition of conservative economic management, Guatemala's stabilization and debt problems are less severe than any of the other countries in the region, but its political and social problems may be the most intractable.

Assistance levels in most recent years have represented minimum programs sufficient to maintain a U.S. aid presence. Such levels have allowed for the initiation of only one new project each year and at a size that permitted only a pilot-type activity rather than broad coverage throughout the rural areas. Programs of this size, while allowing for some innovation, have little real impact on the development needs in Guatemala and provide little incentive for structural changes necessary on the part of the country.

Under the funding levels proposed, USAID would be able to work with a democratically elected GOG and private sector organizations in addressing the development concerns fostering tension and unrest in the rural areas. Programs at these levels would facilitate the policy dialogue needed for the structural and operational changes essential to bringing about long-term, self-sustaining growth with equity in Guatemala. USAID would be able to initiate two to four major projects each year at levels adequate to develop the institutional capacities necessary and deal with the full scope of the problems identified. They would allow for creating a capacity within the country to (1) analyze constraints, identify solutions and plan an integrated development effort; (2) carry out a program of complementary projects which could serve as models for future efforts; and, (3) utilize the acquired experience in improved planning and implementation to increase development assistance from other international donors.

The ESF and P.L. 480 Title I planning levels will obviously not be sufficient in and of themselves to cover the current account balance of payments deficits which will occur even at levels just sufficient to maintain positive per capita growth see Tables 18 and 19). U.S. financing is intended, therefore, to provide for partial coverage together with the additional non-U.S. official and net banking flows and to stimulate the necessary private flows. These private flows, which are shown as residuals in Table 19 for the purpose of indicating what levels are necessary to obtain the desired per capita growth rates, are the key factor in both the high and low economic scenarios. If private flows are not sufficient the desired growth levels will be unobtainable without additional official flows. The local currency generations from these programs will be utilized to support the other development objectives of the Strategy.

The Mission proposed P.L. 480, Title I Program for FY 1985-89 provides for additional balance of payments support and essential food imports. The economic crises and balance of payments deficits which currently affect Guatemala have seriously reduced the country's abilities to import even essential commodities. An important aspect of the Mission Strategy is the economic stability necessary to foster long-term growth. The Economic Support Fund program is directly aimed at this critical need, and a P.L. 480, Title I program can provide additional support while also addressing a food need. Mission programs are currently operating and being developed to address the problems identified. Nevertheless, food imports are needed to cover essential needs over the planning period. Vegetable oil will be in short supply over the proposed years due to the reduction in locally produced cotton seed oil. Cotton production is down because of weak world prices and as such is a contributor to the foreign exchange shortage in Guatemala.

Like most Latin American countries, Guatemala experiences considerable land pressures. One of the planned activities of the USAID is to expand the available land resources through both a land sales program and the colonization activities in the FTN. P.L. 480 resources will be utilized to get a commitment on the part of the GOG to further develop and expand these programs as well as improve the land titling system.

The Mission does not believe that absorptive capacity for non project assistance will pose any problem at the program levels herein proposed. The economic analysis demonstrates that both ESF and P.L. 480 Title I funding levels are within a range required to bring economic activity back to previous levels of growth. The projected rate of expansion of non-traditional exports could be optimistic relative to the economy's capacity to develop that segment, but given its low base and the attention being devoted to export promotion by the GOG and all major donors it is an achievable growth projection.

The principal area of absorptive capacity concern is with the public sector's ability to carry out programs of the size proposed for these DA funding levels. In the near term it should not be a serious problem but over the planning period this is an area of concern.

Both USAID and the GOG have a repressed demand for AID projects because of the artificially low level of USAID budgets in recent years. Activities proposed for FY 84 and 85 are in areas where the GOG and USAID have common experience based on past projects. Over the longer term USAID will be careful not to let the number of projects proliferate and will avoid overly sophisticated project designs which often are the cause of absorption problems. USAID will seek relatively large individual project size while limiting the total number of projects. The Mission will stick to highest priorities, seeking maximum impact there, rather than trying to develop a project to meet every important perceived need.

The management question for the public sector and the questions of availability of counterpart financing and recurrent cost resources remain. The management issue is partially addressed within the programs themselves. Each major project being proposed by USAID includes a technical assistance component directed at institution building, a primary purpose of which is to improve the management capabilities of the executing units. Counterpart financing needs will be partially covered by local currency programs under both ESF and P.L. 480, Title I. In addition, a condition of assistance is improved performance in both social sector expenditures and revenue collections. The GOG will be expected to double over five years the percentage of GDP devoted to social programs affecting the rural poor. This increase is to be financed, at least in part, by allocating not less than 60% of increased revenues generated as a result of revenue enhancement changes adopted by the GOG in consultation with the IMF, World Bank and AID. Therefore, there should be sufficient counterpart financing available to cover the GOG's investment and recurrent cost requirements. Greater use of the private sector, as for example the proposed Agribusiness Development Project for FY 1985, will lower the counterpart and recurrent cost burden of the public sector. However, the overall absorptive capacity issue will require continued close attention by the Mission, especially after FY 85.

The Resource Table following provides a breakdown of the funding for the program as proposed in this Strategy. The table presents both funding by source (i.e., DA, ESF, P.L. 480) and year (FY 85-89).

An increased program as proposed will require additional staff. The program will be focussed on DA project assistance and will require an additional seven positions (assumed as 3 USDH and 4 PSC) in order to be effectively managed. Staffing levels at less than this recommended amount would seriously inhibit the Mission's ability to develop new initiatives and manage such a program.

TABLE 21. APPROVED ASSISTANCE PLANNING LEVELS

($ Millions)

Funding Source	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989	TOTALS
Development Assistance (DA)	40.0	45.5	58.2	53.6	52.4	249.7
Economic Support Funds (ESF)	35.0	25.0	25.0	35.0	40.0	160.0
P.L. 480, Title I	16.0	16.0	16.0	16.0	16.0	80.0
P.L. 480, Title II	5.4	5.4	5.4	5.4	5.4	27.0
TOTALS	96.4	91.9	104.6	110.0	113.8	516.7

TABLE 22: RESOURCE TABLE

(In Millions of U.S. Dollars)

OBJECTIVE/Funding Source	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989	TOTALS
INCREASED RURAL INCOMES AND PRODUCTIVITY						
DA	36.9	41.5	54.2	49.6	48.4	230.6
ESF	--	--	--	--	--	--
(ESF Local Currency)	(17.0)	(12.0)	(12.0)	(15.0)	(15.0)	(71.0)
P.L. 480, Title I	--	--	--	--	--	--
(Title I Local Currency)	(16.0)	(16.0)	(16.0)	(16.0)	(16.0)	(80.0)
P.L. 480, Title II	5.4	5.4	5.4	5.4	5.4	27.0
REDUCED RATE OF POPULATION GROWTH						
DA	3.1	4.0	4.0	4.0	4.0	19.1
ESF	--	--	--	--	--	--
(ESF Local Currency)	(3.0)	(3.0)	(3.0)	(5.0)	(5.0)	(19.0)
P.L. 480, Title I	--	--	--	--	--	--
(Title I Local Currency)	--	--	--	--	--	--
P.L. 480, Title II	--	--	--	--	--	--
BALANCE OF PAYMENTS EQUILIBRIUM AT HIGHER GROWTH LEVELS						
DA	--	--	--	--	--	--
ESF	35.0	25.0	25.0	35.0	40.0	160.0
(ESF Local Currency)	(15.0)	(10.0)	(10.0)	(15.0)	(20.0)	(70.0)
P.L. 480, Title I	16.0	16.0	16.0	16.0	16.0	80.0
(Title I Local Currency)	--	--	--	--	--	--
P.L. 480, Title II	--	--	--	--	--	--

TABLE 23: PERSONNEL TABLE

SECTOR	FY 1985 USDH	FY 1985 FNDH	FY 1985 PSC	FY 1986 USDH	FY 1986 FNDH	FY 1986 PSC	FU 1987 USDH	FU 1987 FNDH	FU 1987 PSC	FY 1988 USDH	FY 1988 FNDH	FY 1988 PSC	FY 1989 USDH	FY 1989 FNDH	FY 1989 PSC
Director	2	2	--	2	2	--	2	2	--	2	2	--	2	2	--
Program	2	4	2	2	4	3	2	4	[illegible]	2	4	3	2	4	3
Project Development	3	6	3	4	6	3	4	6	3	4	6	3	4	6	3
Executive	1	10	4	1	10	4	1	10	4	1	10	4	1	10	4
Agriculture	4	3	2	4	3	2	4	3	2	4	3	2	4	3	2
Human Resources	2	4	1	2	4	1	2	4	1	2	4	1	2	4	1
Health/Population	2	2	1	2	2	1	2	2	1	2	2	1	2	2	1
TOTAL	16	31	13	17	31	14	17	29	14	17	29	14	17	29	14