

GUATEMALA ECONOMIC AND FINANCIAL MISSION

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COMPREHENSIVE GENERAL REPORT



KLEIN AND SAKS

WASHINGTON, D. C.

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GUATEMALA ECONOMIC AND FINANCIAL MISSION

I. COMPREHENSIVE GENERAL REPORT

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A COMPREHENSIVE REPORT OF THE ACTIVITIES OF THE
KLEIN & SAKS ECONOMIC AND FINANCIAL MISSION
IN GUATEMALA

INTRODUCTION

The Administration of President Castillo Armas, when it came into office in mid-1954, found the nation's economy in a virtual state of collapse. The fiscal situation was very grave and the government was burdened with a heavy deficit. Business was at a standstill. Riddled throughout by controls and restrictions private industry was barely holding on. New private capital was impossible to obtain either locally or abroad, while Government capital had been dissipated in a growing number of nonproductive enterprises. Savings within the country were at a rock-bottom low, and there was a continuing flight of capital. Agriculture production was not maintaining pace with the greater consumer demand deriving from an increasing population. Guatemala's gross national product was increasing at a yearly rate of only 2.6 percent compared with 5.5 percent for all of Latin America.

The above in brief was the situation when Klein & Saks was engaged to advise the government in regard to certain designated economic and administrative matters.

In contrast to the above situation the nation's economy at the time of the President's death in mid-1957 was displaying a strength and stability not believed possible of

achievement. The fiscal structure of the government had been put in order. Revenues were up and expenditures were well within the fiscal income. Order was the rule in government administration, rather than the exception. Guatemalan flight capital had returned and foreign capital was viewing the new administration's actions as favorable to investment. The abolition of controls and a recharting of government policies was sparking agriculture and industry into activity. Unemployment has been eliminated as a problem.

Since the death of the President his interim successors have continued his policies, but progress has been at a slower rate. The disturbing events in the country since the President's death have injected a wait-and-see attitude on the part of the people and introduced a measure of uncertainty as to the future planning of the government. Just as the Mission worked with President Castillo Armas and his government, so it is now working with his successors. The present is again a crucial period in Guatemala's history. The Mission is hopeful that it can contribute to the maintenance of the economic gains the nation has so far achieved and to assist it in reaching a still greater level of prosperity.

SUMMARY

The Klein & Saks contract with the International Cooperation Administration to render advisory service to Guatemala in the economic and financial fields was signed on January 28, 1955, and remained in effect until the end of 1957. Five days after the contract was signed, Mr. Julien M. Saks, a partner in the firm, arrived in Guatemala City and met with Guatemalan Government officials, members of the United States Operations Mission (USOM), and the United States Ambassador and his associates at the United States Embassy to determine the most urgent problems facing the government and to reach agreement on the scope of the advisory assistance which a Klein & Saks Economic and Financial Mission would offer. It was agreed that there were many phases of the government's operations which needed prompt technical guidance.

The administration of President Castillo Armas, which followed the ousted Arbenz regime, had inherited a very disrupted economy and a confused administrative organization. Revenues had been declining while government expenses continued to mount. There was disorganization in the budgetary system and a resulting lack of administrative control. The whole structure of the new government lacked a unity of effort and purpose. A complete changeover at the top level of authority and the unfamiliarity of most of the new officials with the

specific tasks before them had resulted in a crisscrossing of effort or even a failure to take action in the belief that the problem was the responsibility of someone else.

Under the agreement reached by Mr. Saks with the Guatemalan officials and the USOM it was decided to direct the Mission's assistance first to the budget and taxation problems, in line with the determination to tackle the most urgent tasks as quickly as possible. It was agreed that Klein & Saks would

- (1) send immediately a Mission team to Guatemala to work with government officials in the identified areas;
- (2) render general economic policy guidance and specific additional technical assistance as this became necessary, and
- (3) simultaneously make available to the government the full facilities and know-how of its Washington office and staff.

Early in March of 1955, Mr. Howard Tewksbury, a retired career Foreign Service Officer and former U. S. Ambassador to Paraguay, and former head of the Klein & Saks Mission to Peru, arrived in Guatemala City and proceeded to organize the program of technical assistance which the Klein & Saks Mission was requested to render. Shortly thereafter an expert in budget procedures and techniques as well

as a tax specialist were assigned to the Mission. Intensive studies of the budget and the tax system were started immediately.

In a very short time Mission personnel were working side by side with Guatemalan fiscal officers and offering pertinent and constructive advice. The initial objective was to ascertain the government's actual fiscal situation and to inject as soon as possible a measure of working order into its budgetary operations. For the longer term it was generally agreed that the whole budgetary system needed basic redesigning and streamlining.

Thorough and detailed studies on the part of the Mission brought to light the massive red-tape restrictions in the allocation and disbursement of funds; improper operating and administrative procedures which were time consuming and non-productive; a lack of data on the actual payment of various expense items, etc. On the spot recommendations for improvements in techniques or substance were made whenever possible and formal report writing as such was held to a minimum. In addition, time was taken to train workers at the staff level so that a recommended procedural change became a permanent adoption.

While the Mission's efforts soon began to show results in the general fiscal fields they also brought to light the weaknesses in important related aspects of the economy. The

customs tariff, an important source of revenue in Guatemala, had not been codified nor otherwise brought up to date in many years. The dominant specific duty makeup of the import tariff did not permit of any automatic adjustment to take advantage of the rapid rise in commodity prices in the periods following World War II and the Korean crisis. Customs revenues as a consequence were static. Moreover, the whole customs operation and procedures were in dire need of being modernized in order to expedite the movement of import merchandise and to reduce to a minimum the obstacles which made commodity purchases abroad unnecessarily costly and sometimes hazardous. Also tied directly to the government's fiscal responsibilities was the question of its social security obligations and the Mission was specifically asked to look into this latter matter by President Castillo Armas.

In addition, it was quite apparent that the haphazard growth of government functions over the previous years was working a hardship on private enterprise which found itself competing with the government in many lines. The trend over the years to allocate to government autonomous and semi-autonomous agencies those functions generally carried on by private business resulted in an expanded participation by government in commerce and trade with the usual resulting overstaffing, duplication, inefficiency, etc.

Selective assistance, therefore, on the part of the Klein & Saks Mission was rendered to Guatemala to a very important degree in the following areas:

- (1) public administration,
- (2) taxation,
- (3) Social Security,
- (4) budget and budgetary procedures,
- (5) accounting and audit practices,
- (6) customs tariffs and customs regulations, and
- (7) economic problems.

It can now be reported that important progress has been made in each of the above specific fields. More general but of tremendous importance has been the overall economic advisory assistance rendered to the government on a day-to-day or spot basis. In this connection Dr. Julius Klein, Mr. Julien M. Saks, and Mr. Richard L. Davies, the firms's Executive Director, made regular visits to Guatemala to counsel on the Mission's programs and the planning of the government's longer term policies.

SPECIFIC PROGRAMS

1. Public Administration

In response to a request made in late 1955 by President Carlos Castillo Armas, the Mission undertook major studies in the field of public administration. First a study was made of the organizational structure of the Executive Branch of the Government. Recommendations were prepared to provide the government with a logical and efficient organization with clear cut areas of responsibility and definite lines of authority. These recommendations were included in a printed report entitled "Informe sobre la Reorganizacion del Ramo Ejecutivo del Gobierno de la Republica de Guatemala" submitted to the President in November 1956.

The President was favorable to the Mission's recommendations and evidenced his great personal interest in them. He gave extensive audiences to the Mission to discuss various of these suggestions. In the following July he gave instructions to proceed with the preparation of the necessary legal instruments to carry out the plan. The technical work, including specific reorganization plans, required to accomplish the reorganization were completed at the time of the President's death. However, the political developments and confusion following his assassination have postponed the projected program. Interim President Col. Flores Avendano and his immediate advisors meanwhile have expressed considerable interest in the

work which the Mission had done in this field and copies of the various reports, reorganization plans and proposed organization charts were made available for their study.

In addition to the Mission's recommendations on the overall organization of the Executive Departments, studies were also undertaken for the President on the work of his own office and a series of special recommendations were prepared for him. Most of these were adopted during the period before his assassination and included such measures as the establishment of a National Personnel Department, broadening of the scope of activities of the Secretary General of the Presidency, clarification of the lines of authority of the President's assistants, etc. The Mission's recommendations regarding the reorganization of the public relations activities of the Presidency were put into effect early in the administration of President Castillo Armas. The only major recommendation with respect to the reorganization of the Presidency which was not adopted was the transfer of the Budget Office from the Ministry of Finance to the Presidency. However, this matter has been under serious consideration by the interim administration of President Flores Avendano and special additional studies were submitted to the Government on this subject.

In addition to the above major projects which were undertaken in the public administration field, the Mission was called upon to advise the government with respect to many

related public administration items. These included the development of a plan for the operation of the government owned farms (Fincas Nacionales) under a government corporation, recommendations with regard to reorganization of the National Economic Planning Council, development of a proposal for the establishment of a National Housing Institute, and similar special projects. In most cases the Mission's assistance included, aside from the basic detailed studies, preparing the suggested functional organization charts, working up detailed statements supporting the proposals, and in some instances, assisting in the drawing together of the proposed legislation or executive orders necessary to carry out the recommendations.

2. Taxation

In the tax field the Mission undertook exhaustive studies of the principal revenue producing tax laws and made numerous suggestions for improving tax collections and for broadening the tax base. The decision to analyze and review the principal tax producing measures of the Government rather than to concentrate on first codifying the tax laws, was made after a preliminary study of the overall tax law structure revealed that a codification attempt would take considerable time and would not be contributory to the immediate problem. Many of the tax laws were either not being enforced or forgotten. It was decided therefore that early improvement in tax application and tax collections could best be achieved through an approach involving: (1) concentration on enforcement and better administration of the principal tax measures; and (2) the introduction of an income tax system.

In this latter connection, the Mission's investigation of the revenue possibilities of the country, involving a very substantial amount of time, revealed the many shortcomings of the existing tax structure. This investigation brought to the fore also the many administrative practices of the Government which could be improved immediately with resulting higher tax collections. Through day-to-day counsel with Guatemalan tax officials on these matters, the suggested improvements were brought to their attention and in most instances, adopted.

On the longer term problem, the Mission was working with the Government in the preparation of an overall income tax law. After a complete evaluation of the country's income potential, an income tax law project was completed and approved by the Government. This measure, should it become law, will establish a new income tax system in Guatemala. Its application will give the nation the income revenue it must have to enable it to continue the building up of the country's economy through the full utilization of its natural and human resources.

The recommended income tax law is currently awaiting the action of the Guatemalan Congress.

10 Day Study

3. Social Security

President Castillo requested the Mission near the end of his first year in office

- (1) to study the Guatemalan Social Security Program and
- (2) to make recommendations to improve its administrative structure and expand the services it was rendering.

This evaluation of the Social Security system pointed up the urgent need for greater medical care and for extending the program to provide particularly for widows and orphans of all deceased workers, for the disabled, and for the aged. At the same time it also revealed that the principal problem facing the Social Security Institute, which administers the program, was how to reduce the high costs of present services so as to enable it to expand the program gradually to other risks without imposing too heavy a burden on employers and workers through further increases in contributions to cover this expansion.

The Mission's review identified the basic weaknesses in the system. Some recommendations regarding means of cutting administrative costs have been acted on and some improvement has resulted. Achievement of many additional services, however, will depend to a considerable degree on an increase in the supply of doctors and nurses and a broader hospital program.

4. Budget

By the time the Mission arrived in Guatemala it had already become apparent to the government that its budgetary techniques were desperately in need of basic reform and modernization. It was very evident at the beginning of the Mission's studies that the budget was an unreliable guide to an evaluation of the government's fiscal operations. The budget system was on a so-called cash basis and did not take into consideration accounts payable, accrued accounting or obligation accounting. Large amounts of special and regular revenues were received and disbursed without passing through the budget. The problem was further complicated by the fact that the country was operating during the first year of the Castillo Armas administration under one budget for part of the year and under another budget for the remainder of the year. Other important weaknesses were the requirement for pre-audit of all account items, the system's inability to accommodate the adjustments made necessary as a result of changes occurring within the course of the fiscal period, and the lack of control by the Executive over the budget.

The Mission undertook, in cooperation with the Guatemalan Government, to bring about urgently required improvements, with concentration being first directed to changes which could be made without new legislation. In-service training of Guatemalan technicians under the Mission's guidance became an important part of the program. Simultaneously also the Mission aided

in the preparation of each new year's budget on the basis of revised procedures so that the previously identified weaknesses would not be perpetuated. And finally a long term modernization of the budget format and budget techniques was worked up with Guatemalan officials. A very important aspect of this revamping was to make the Budget Office directly responsible to the President. A recommendation of the Mission, after exhaustive study, outlining the advantages to be derived from the transference of the Budget Office to the Presidency, and containing detailed organization responsibilities under the proposed setup was prepared for the government but has not yet been implemented. Complete data on the procedural means of achieving this change-over when approved by the Congress have already been prepared.

A great many budgetary improvements have already been adopted and today's budget is more smooth and more systematic than its predecessors. There are still many refinements which must be made and it is in this area that the Mission is currently working with the Guatemalan Government. There is also the objective of a performance budget format. This had been engaging the attention of the Mission for some time and appears to be now in sight.

5. Accounting

A very important aspect of the Mission's work was the assistance it rendered in improving the nation's general accounting and audit procedures. Work in the budgetary field revealed a need for technical aid to correlate more closely accounting practices with budgetary allocations, including pre and post audit practices. An examination of the problem brought to light the great many inadequacies which existed. It became quite evident that the whole General Accounting Office structure was in need of streamlining and modernization.

The Mission's program, therefore, went to the base of the problem. After exhaustive studies of the existing operations, detailed accounting manual instructions were written to implement the recommended changes in an orderly manner and on a permanent basis; daily step by step procedural guidance was maintained and problems were resolved on the spot; special intensive training courses were set up so that the complete system could be carried out by Guatemalan technicians who were to be responsible for its operation and for making it a success. As a consequence of this guidance and training effort the modernization and increased mechanization of the Guatemalan Government's general accounting methods and procedures was accomplished during the contract period.

It should also be noted that simultaneously with the Mission's assistance in the General Accounting Office, similar type assistance was requested and given to the individual Ministries and to the working staffs in the divisions within the Ministries so that the accounting system of the Executive Branch of the Government as a whole could be adapted as smoothly as possible to the improvements set up in the General Accounting Office.

6. Customs Tariffs

Just as improved techniques have been injected into the tax system so have improvements already been made in the nation's customs tariffs procedures and customs practices. The work of the Mission in the customs field has been carried on throughout the Mission's contract tenure for two principal reasons. One was an urgent need for administrative efficiency in order to increase fiscal receipts. The other was to recast the Guatemalan customs tariff so that it would conform to the Uniform Central American Customs Tariff Nomenclature (NAUCA) system in line with an agreement reached by the Central American Republics.

In the still longer period, possibly greatly increased collections will be obtained from the Revised Customs Tariff after it is adopted by the Congress and placed into effect. In the meantime the customs administration has been improved as a result of on-the-spot counsel from the Mission.

The difficulties of the Mission's task, however, are not apparent from the mere indication of the job which was done. In the projected transition to the NAUCA tariff it has been necessary completely to revise tariff classifications and to make sure that every possible item, specifically classified or not, would fall within a definite identifiable category. In the changeover to the NAUCA system it was decided, on the Mission's recommendation, to revise specific rates so that the

tariff would reflect the increased costs of merchandise which have occurred in the past ten to fifteen years. This task involved the accumulation and interpretation of a most substantial mass of data. Import statistics providing average figures for a five year period (1950-1954) showing quantity, value, duty rate, amount collected and the advalorem equivalent of every specific rate of import duty had to be compiled. Using these data, coupled with information derived from other sources, visits to factories, studies with respect to local manufacturing costs, etc., rates of import duty were suggested for all headings in the NAUCA tariff - with comments and statistical data in support of every proposed rate. The comments ran to approximately 1200 pages. Several parts of this study have already been made available to the ICA in Washington.

With a new tariff in prospect, opportunity was taken to recommend the elimination of many extra levies which weigh on and complicate the tariff structure. It should also be added that the import duty rates proposed for textiles have been devised so as to permit the cancellation of the Textile Compensation system - an arrangement which, in effect, tends to increase costs of textiles without any resulting benefit for either the consumer or the national economy. Full consideration was given during the tariff studies to trade agreements with other countries, especially the United States and the other Central American countries, to the possible development

of an integrated economy among the five Central American countries and to the country's possible eventual participation in the General Agreement on Tariffs and Trade (GATT).

A very important achievement affecting the United States was the completion of action to eliminate the discriminating treatment against American automobiles imported into the country, by requiring European car shippers to declare the value of their cars for import duty purposes on the same basis as American and Canadian cars - the net FOB factory price. Previously European cars were dutiable on a wholesale price to dealers basis - a value much lower than the ex-factory list price.

After the drafting of the customs tariff had been completed the Mission contributed major assistance to modernize the customs code and regulations. Studies made so far have related in the main to imports, including parcel post traffic concerning which complaints about vexatious delays and red tape had come from all sides. Also a study was made and recommendations offered concerning the setting up of an appraising unit at the Central Custom House, inasmuch as the NAUCA Customs Tariff, when adopted, will carry many advalorem import duty rates.

7. General Economic Advisory Services

The Mission's counsel to the Guatemalan Government in the specific fields mentioned above was only part of the economic advisory assistance rendered to the Government. Just as important, but not as quickly reflected in tangible results, were the overall suggestions and recommendations offered by the Mission through the National Advisory Planning Council and on a day-to-day basis of contact with top Government leaders. This part of the Mission's work also had the benefit of the broad experience of the firm itself, including its complete Washington staff.

The Guatemalan economy had been trending for many years toward Statism. Owing to many factors, including a traditional paternalistic policy toward the majority Indian elements, this tendency toward Statism had begun to become rooted in the political and social system. It had been encouraged by Guatemalan political elements oriented with the Soviet Union.

The Revolutionary Government of President Castillo Armas was determined, however, to reverse the trend and to allow the forces of free enterprise, under reasonable government regulation, to develop the economy. The Klein & Saks Mission actively assisted the government toward this objective.

The general policy matters on which the Mission gave advice were as broad as the nation's economy itself. The Mission was in daily touch with the country's economic policy-making staff, and met at frequent intervals with the President.

Close contact was maintained with the Cabinet, and viewpoints on important planning were exchanged. A most important factor in the Mission's counseling was its impartiality and objectivity. Normally several desirable alternative courses of action were suggested with a listing of the advantages and disadvantages of each course so as to enable the government to be fully advised in making its decisions.

Late in 1955 the government compiled a study of a projected economic program for 1956-1960. The Mission's review of this program and its recommendations concerning it were considered so helpful by the Government that the project was importantly revised to include the Mission's recommendations which stressed the points for achieving a more rounded economy in which private enterprise would play a major part.

In this connection the President appointed a Private Initiative Commission, at the Mission's suggestion, to establish an investment climate that would encourage foreign capital to invest and settle in Guatemala. The meeting of this Commission in July 1957, opened by the President himself, highlighted the economic improvement the nation has achieved and indicated the growing attractiveness of the country to foreign investors.

The Mission also worked with the government to help improve agricultural production. A study of the Mission developed the fact that the Guatemalan economy was deficient in practically all basic food production, except sugar and coffee. An exhaustive study of corn production, Guatemala's most

important food, identified the shortcomings which must be corrected to bring improvement to the producer and the consumer alike.

Among actions in the industry field, the Mission

- (1) actively encouraged and assisted the government in its plan to open up its territory to oil exploration;
- (2) contributed to the encouragement of American capital investment in Guatemala; and
- (3) made suggestions regarding means for encouraging settlers to make their homes near the new road networks so as to develop the new areas as quickly as possible.

At the time of President Castillo's death in July of last year, Guatemala's economy had reached a point of progress which was thought hardly possible two years earlier considering the problems the government had inherited. There has now been laid a basis on which to build, but the tasks facing interim President Flores Avendano and President-elect Ydigoras are still great ones. There is much to be done in order to increase food production, to expand industry, and, among other things, to carry out a well-directed program for developing the country's natural resources.

The Mission is continuing to work very closely with the Presidency, which is moving ahead with the implementation of the Mission's recommended program. There are still many

problems needing urgent attention and the Klein & Saks Mission in Guatemala and the Klein & Saks staff in Washington look forward to the privilege of being helpful to President-elect Ydigoras and to Guatemala in the challenging years ahead.

Klein & Saks has appreciated the opportunity given by this contract with ICA to work with the Guatemalan Government, the Guatemalan Embassy in Washington; the State Department and the United States Embassy in Guatemala; and the International Cooperation Administration in Washington, and the United States Operations Mission in Guatemala.

The splendid cooperation of everyone in these organizations has been essential to the success of the work which Klein & Saks has been doing in Guatemala.