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# Guatemala

## Economic Performance Assessment



**May 2006**

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# **Guatemala**

## **Economic Performance**

### **Assessment**

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Sponsored by the Economic Growth office of USAID's Bureau of Economic Growth, Agriculture and Trade (EGAT), and implemented by Nathan Associates Inc. under Contract No. PCE-I-00-00-00013-00, Task Order 004, the Country Analytical Support (CAS) Project, 2004-2006, has developed a standard methodology for producing analytical reports to provide a clear and concise evaluation of economic growth performance in designated host countries. These reports are tailored to meet the needs of USAID missions and regional bureaus for country specific analysis. Each report contains:

- A synthesis of data drawn from numerous sources, including World Bank publications and other international data sets currently used by USAID for economic growth analysis, as well as accessible host-country data sources;
- International benchmarking to assess country performance in comparison to similar countries and groups of countries;
- An easy-to-read analytic narrative that highlights areas in which a country's performance is particularly strong or weak, thereby assisting in the identification of future programming priorities.

Under the CAS Project, Nathan Associates will also respond to mission requests for in-depth sector studies to examine more thoroughly particular issues identified by the data analysis in these country reports.

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## HIGHLIGHTS OF GUATEMALA'S PERFORMANCE

Economic Growth	Guatemala suffered from relatively slow growth in the early 2000s. This was due mainly to the slowdown in demand from its main trading partner, the United States, which was exacerbated by the economic shock dealt by the September 11, 2001 terrorist attacks. Recovery in U.S. demand for Guatemalan products in 2004 and the pro-growth policies of the Berger Administration established the basis for improved growth rates. Nevertheless, the country still faces significant competitiveness challenges.
Poverty and Inequality	Guatemala has a high level of poverty and has the second-worst income distribution of any country in Latin America. Incomes of indigenous Guatemalans are particularly low relative to those of non-indigenous Guatemalans.
Economic Structure	The number of Guatemalans employed in agriculture is much greater than the regional average. The majority of the country's value-added activities are in the services sector, including tourism.
Demography and Environment	Guatemala has a relatively high rate of population growth yet a lower-than-predicted rate of urbanization. Guatemala also has a low rate of adult literacy and a poor level of environmental stewardship.
Gender	Guatemala performs poorly on all measures of gender equality.
Fiscal and Monetary Policy	Guatemala's fiscal and monetary policy management are very prudent. Although government revenues are low, the Berger Administration and donors are working on ways to increase them.
Business Environment	The low level of "rule of law" and the high levels of crime and violence are significant impediments to economic growth. Guatemala scores relatively positively on business procedures although the application of these procedures can often be complicated.
Financial Sector	Guatemala's financial sector offers significant impediments to small and medium-sized enterprises seeking to access capital. The Berger Administration is working actively to improve this situation through a variety of channels.
External Sector	CAFTA-DR will be the central opportunity and challenge for the Guatemalan economy in the coming years. Guatemala has low levels of public debt and very high levels of capital inflows from remittances.
Economic Infrastructure	Guatemala's economic infrastructure is suboptimal. Upgrading the capacity and efficiency of the country's ports is essential for increased trade resulting from CAFTA-DR.
Science and Technology	Guatemala seems to have little in the way of home-grown innovation. Although Guatemala benefits from a good amount of technology transfer with new FDI, its performance in this area is slightly below the regional average.
Health	Guatemala has a very poor quality of public health. Children are particularly vulnerable.
Education	Access to basic education and student retention have improved significantly in the past five years. However, indigenous Guatemalans have half as much education as nonindigenous Guatemalans.
Employment and Workforce	Participation in the formal labor force is extremely low. An estimated 75 percent of workers in rural areas work informally.
Agriculture	Although the level of value added per worker exceeds the regional average, the Guatemalan agriculture sector remains relatively inefficient.

*Note: The methodology used for comparative benchmarking is explained in the Appendix.*



## GUATEMALA: NOTABLE STRENGTHS AND WEAKNESSES— SELECTED INDICATORS

Indicator	Strength	Weakness
Growth Performance		
Real GDP Growth (2005)	✓	
Share of gross fixed investment in GDP, current prices		✓
Growth in labor productivity		✓
Poverty and Inequality		
Poverty headcount		✓
Ratio of income share accruing to richest 20% to share of poorest 20%		✓
Economic Structure		
Output structure, services value added, % GDP	✓	
Demography and Environment		
Population growth rate		✓
Age dependency rate		✓
Environmental sustainability index		✓
Gender		
Male-to-female adult literacy rate		✓
Fiscal and Monetary Policy		
Government revenue, %GDP		✓
Cash Surplus/Deficit (% of GDP)	✓	
Growth in the broad money supply	✓	
Business Environment		
Rule of Law index		✓
Corruption Perception index		✓
Procedures to register property	✓	
Time to enforce a contract		✓
Financial Sector		
Domestic credit to private sector, % GDP		✓
Real interest rate	✓	
External Sector		
Trade Policy index	✓	
Present value of debt, % GNI	✓	
Inward FDI potential index		✓
Economic Infrastructure		
Quality of Infrastructure index		✓
Internet users per 1,000 people		✓

Indicator	Strength	Weakness
Science and Technology		
Patent applications filed by residents		✓
Health		
Maternal mortality rate, per 100,000 live births		✓
Births attended by skilled health personnel		✓
Prevalence of child malnutrition (weight for age)		✓
Education		
Persistence in school to grade 5 (total) (2005)	✓	
Youth literacy rate		✓
Employment and Workforce		
Labor force participation rate (total) (in the formal sector)		✓
Labor force participation rate (female) (in the formal sector)		✓
Agriculture		
Agriculture value-added per worker	✓	
Cereal yield		✓

*Note: The chart identifies indicators for which Guatemala's performance is particularly strong or weak relative to the benchmark standards; details are discussed in the text. The separate Data Supplement for Guatemala presents a full tabulation of the data examined for this report, including the international benchmark data, along with technical notes on the data sources and definitions.*

# 1. Introduction

This paper is one of a series of economic performance assessments prepared for the EGAT Bureau to provide USAID missions and regional bureaus with a concise evaluation of a broad range of indicators relating to economic growth performance in designated host countries. The report draws on a variety of international data sources<sup>1</sup> and uses international benchmarking against reference group averages and comparator countries (Chile and Costa Rica<sup>2</sup>) to identify major constraints, trends, and opportunities for strengthening growth and reducing poverty.

The methodology used here is analogous to examining an automobile dashboard to see which gauges are signaling problems. Sometimes a blinking light has obvious implications—such as the need to fill the fuel tank. In other cases, it may be necessary to have a mechanic probe more deeply to assess the source of the trouble and determine the best course of action.<sup>3</sup> Similarly, the Economic Performance Assessment is based on an examination of key economic and social indicators, to see which are signaling problems. In some cases a “blinking” indicator has clear implications, while in others a detailed study may be needed to investigate the problems more fully and identify an appropriate course for programmatic action.

The analysis is organized around two mutually supportive goals: transformational growth and poverty reduction.<sup>4</sup> Rapid and broad-based growth is the most powerful instrument for poverty reduction. At the same time, measures aimed at reducing poverty and lessening inequality can help to underpin rapid and sustainable growth. These interactions create the potential for stimulating a virtuous cycle of economic transformation and human development.

Transformational growth requires a high level of investment and rising productivity. This is achieved by establishing a strong enabling environment for private sector development, involving multiple elements: macroeconomic stability; a sound legal and regulatory system, including secure contract and property rights; effective control of corruption; a sound and efficient financial

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<sup>1</sup> Sources include the latest data from USAID’s internal Economic and Social Database (ESDB) and readily accessible public information sources. The ESDB is compiled and maintained by the Development Information Service, under PPC/CDIE and is accessible to USAID staff through the USAID intranet.

<sup>2</sup> Chile and Costa Rica were selected by the LAC Bureau as comparators for CAS reports on CAFTA countries. These two countries represent regional best practices for small Latin American countries.

<sup>3</sup> Sometimes, too, the problem is faulty wiring to the indicator—analogous here to faulty data.

<sup>4</sup> In USAID’s white paper *U.S. Foreign Aid: Meeting the Challenges of the Twenty-first Century* (January 2004), transformational growth is a strategic objective, both for its innate importance as a development goal and because growth is the most powerful engine for poverty reduction.

system; openness to trade and investment; sustainable debt management; investment in education, health, and workforce skills; infrastructure development; and sustainable use of natural resources.

In turn, the impact of growth on poverty depends on policies and programs that create opportunities and build capabilities for the poor. We call this the pro-poor growth environment.<sup>5</sup> Here, too, many elements are involved, including effective education and health systems, policies facilitating job creation, agricultural development (in countries where the poor depend predominantly on farming), dismantling barriers to micro and small enterprise development, and progress toward gender equity.

The present evaluation of these conditions must be interpreted with caution, because a concise analysis of this sort cannot provide a definitive diagnosis of economic problems or simple answers to questions about programmatic priorities. The aim of the analysis is to spot signs of serious problems for economic growth, on the basis of a review of selected indicators, subject to the limits of data availability and quality. The results should provide insight about potential paths for USAID intervention to complement on-the-ground knowledge and further, in-depth studies.

The remainder of the report discusses the most important results of the diagnostic analysis, in three sections: Overview of the Economy; Private Sector Enabling Environment; and Pro-Poor Growth Environment. Table 1-1 summarizes the topic coverage. A concluding section summarizes the key findings and central messages. Finally, the Appendix provides a brief explanation of the criteria used for selecting indicators, the benchmarking methodology, and a table showing the full set of indicators examined for this report.

Table 1-1  
*Topic Coverage*

Overview of the Economy	Private Sector Enabling Environment	Pro-Poor Growth Environment
<ul style="list-style-type: none"> <li>•Growth performance</li> <li>•Poverty and inequality</li> <li>•Economic structure</li> <li>•Demographic and environmental conditions</li> <li>•Gender</li> </ul>	<ul style="list-style-type: none"> <li>•Fiscal and monetary policy</li> <li>•Business environment</li> <li>•Financial sector</li> <li>•External sector</li> <li>•Economic infrastructure</li> <li>•Science and technology</li> </ul>	<ul style="list-style-type: none"> <li>•Health</li> <li>•Education</li> <li>•Employment and workforce</li> <li>•Agriculture</li> </ul>

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<sup>5</sup> A comprehensive poverty reduction strategy also requires programs to reduce the vulnerability of the poor to natural and economic shocks. This aspect is not covered in the template because the focus is economic growth programs. In addition, meaningful and readily available indicators of vulnerability are difficult to find.

## 2. Overview of the Economy

This section reviews some basic information on Guatemala's macroeconomic performance, poverty and inequality, economic structure, demographic and environmental conditions, and indicators of gender equity.<sup>6</sup> Some indicators are descriptive rather than analytical and are included to provide context for the performance analysis.

The inflection point for any analysis of contemporary Guatemala is the signature of the peace accords in 1996, which ended the 36-year civil war. Although the 21 agreements, acts, and declarations focused on the cessation of hostilities, disarmament, and human rights, they also included a multitude of commitments on how the country would be governed in the post-war period in areas ranging from tax policy to social spending to labor rights to investments in rural infrastructure.<sup>7</sup>

Although the peace accords established the blueprint for the new Guatemala, the foundations of the country's post-1996 economic policy were laid in the decade before the end of the war. The import-substitution model, which had underpinned the strategy for Guatemalan and Central American development since the 1950s, collapsed with the onset of the debt crisis in the early 1980s. With the realization that the old system could not be resuscitated, Guatemala, like many developing countries, initiated market-based economic reforms in the late-1980s.

Although Guatemala has remained at peace since 1996, certain commitments in the peace accords, particularly with respect to economic growth and tax collection, have not been fully implemented. Relatively slow economic growth, averaging only 2.5 percent over the past five years, and weak tax collection have resulted in low levels of public investment and social spending. This, in turn, has hurt Guatemala's broader efforts to enhance its productivity, competitiveness, and attractiveness as an investment and production location. As a consequence, the country, in certain cases, has not garnered the maximum benefits from pro-market policies. Another regrettable development in Guatemala in recent years, related at least indirectly to slow growth and low levels of social spending, has been an upsurge in crime, violence, and social disorder. Because regional competition is set to intensify with the imminent entry into force of the United States–Central America and Dominican Republic Free Trade Agreement (CAFTA-DR), Guatemala must redouble its efforts to enhance its private sector–enabling environment and establish a pro-poor growth environment.

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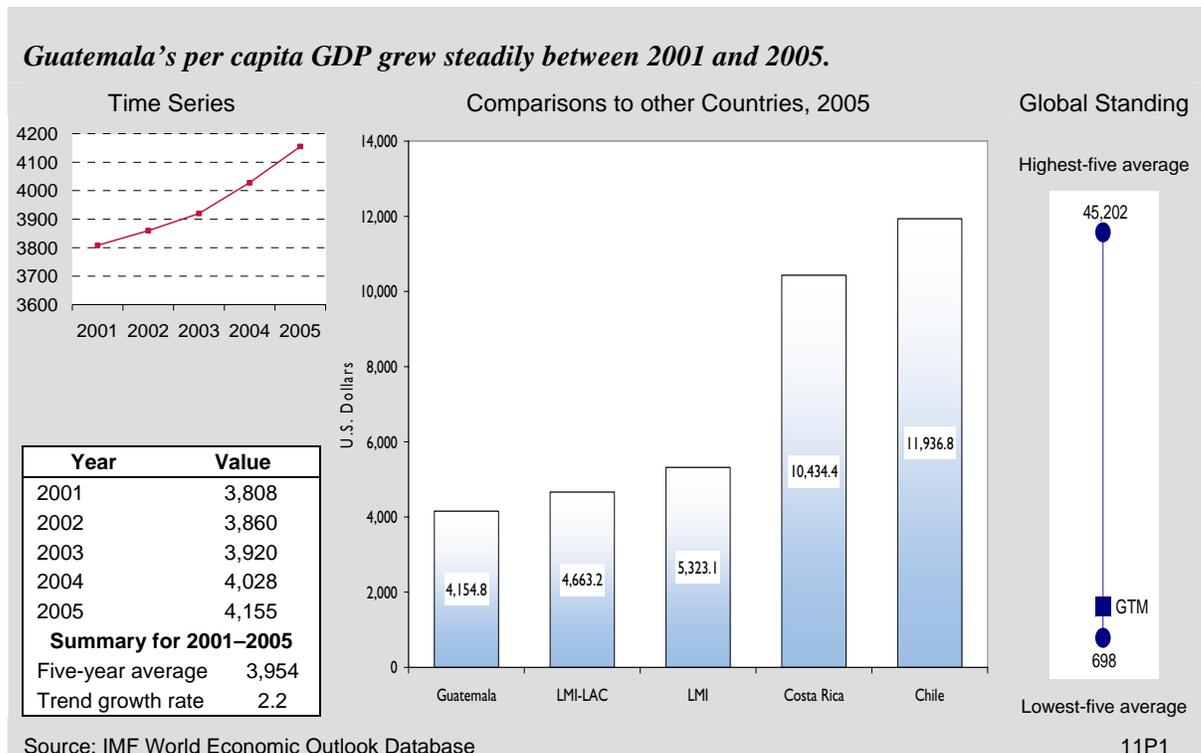
<sup>6</sup> The separate Data Supplement provides a full tabulation of the data for Guatemala and the international benchmarks, including indicators not discussed in the text, as well as technical notes for each indicator.

<sup>7</sup> The text of the peace accords is available at [http://www.congreso.gob.gt/gt/acuerdos\\_de\\_paz.asp](http://www.congreso.gob.gt/gt/acuerdos_de_paz.asp).

## GROWTH PERFORMANCE

With an estimated per capita income of \$4,155 (in PPP US\$), Guatemala is not a poor country, despite being slightly below the \$4,663 average for lower-middle-income countries in Latin America and the Caribbean (LMI-LAC). Although its GDP per capita grew by an average of 2.2 percent per year over the past five years, this rate is a long way from the rates of comparator countries for this report, Chile and Costa Rica, which have per capita GDPs (in PPP US\$) of \$11,937 and \$10,434, respectively (Figure 2-1).

Figure 2-1  
GDP Per Capita, \$PPP



Paragraph 18 of the peace accord, Agreement on Socioeconomic Aspects and the Agrarian Situation, established that the government would adopt economic policies that would permit the country to have a sustainable growth rate of no less than 6 percent annually.<sup>8</sup> Despite this ambitious target, Guatemala's growth performance from 1996 to 2004 was disappointing, averaging some 3.3 percent per annum.<sup>9</sup> Real GDP growth between 2001 and 2003 was particularly sluggish, with Guatemala growing a scant 2.2 percent per annum. By 2005, the economy was growing at 3.2 percent. By contrast, the LMI-LAC average was 3.7 percent and the rates for Chile and Costa Rica were 6.1 and 3.2 percent respectively. Although Guatemala's 2005

<sup>8</sup> See *Acuerdo sobre aspectos socioeconómicos y la situación agraria*. (Signed on May 6, 1996). <http://www.congreso.gob.gt/Docs/PAZ/ACUERDO%20SOBRE%20ASPECTOS%20SOCIOECON%20Y%20SITUACION%20AGRARIA.pdf>.

<sup>9</sup> *Guatemala Country Economic Memorandum: Challenges to Higher Economic Growth*. World Bank, March 2005, p. ii.

performance is a notable improvement, a rate of 3.2 percent cannot generate sufficient levels of employment and economic dynamism necessary to reduce poverty. Moreover, this is still barely half the level committed to in the peace accords and generates insufficient revenues for undertaking the mandated public and social investments.

The immediate causes of slow growth in Guatemala are inadequate investment and low productivity. For 2004, gross fixed investment was estimated at 17.6 percent of GDP, nearly a point lower than the LMI-LAC average (18.5 percent) and significantly lower than the statistically predicted benchmark<sup>10</sup> of 24.3 percent. Guatemala has experienced negative growth in labor productivity in recent years, with rates that averaged about -1.1 percent per annum between 2001 and 2003. By contrast, Costa Rica, a key competitor with Guatemala for the foreign investment and rationalization of production that will come as a result of CAFTA-DR, saw 3.7 percent growth in labor productivity in 2003. Chile, meanwhile, posted 1.6 percent growth in labor productivity.

The investment productivity numbers, known as the incremental capital output ratio (ICOR), tell the same story of declining competitiveness. In 2000, Guatemala had an ICOR of 4.3, yet by 2004, the country's ICOR had jumped to 7.0. In other words, Guatemala requires \$7 of gross investment for every \$1 of extra output. By contrast, regional competitor Costa Rica requires \$6.2 of gross investment for every \$1 of extra output, while Chile requires only \$5.6 for every extra \$1 output. Although the ICOR numbers should be treated as indicative estimates, given the quality of capital stock and investment data, the results do confirm other indications of poor productivity growth.

Guatemala finished 97th out of 117 countries in the 2005 Global Competitiveness Report of the World Economic Forum. In September 2005, during the same week as the release of this report, the government of Guatemala launched its competitiveness program for the coming decade, Agenda Nacional de Competitividad 2005–2015. The agenda, which is the result of a broad-based consultation process, has six strategic themes: (1) human capital development, (2) institutional strengthening, (3) cluster development for exports, (4) infrastructure development, (5) environmental and business social responsibility, and (6) rural economic development.<sup>11</sup> The degree to which the agenda will assist Guatemala in climbing the competitiveness ladder remains to be seen. Two of the principal factors in determining its success will be (1) whether the government of Guatemala puts real money (either its own resources or donor financing) behind the fulfillment of these objectives and (2) whether the individual subprojects developed and implemented under each of the themes are structured to enhance productivity, growth, and pro-poor development. Donors should consider financing projects in one or a number of the thematic areas of the agenda. When designing these activities, donors should work with their partners in the country to structure these programs in a pro-growth, pro-development manner.

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<sup>10</sup> A detailed description of the methodology used to determine the regression benchmark can be found in the Appendix of this document (page A-2).

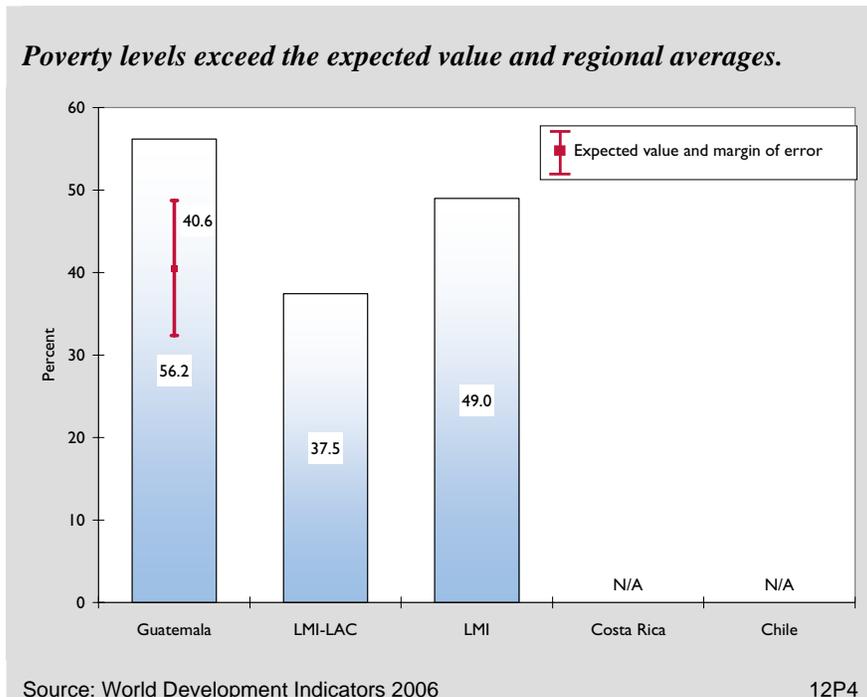
<sup>11</sup> *Country Report: Guatemala*. The Economist Intelligence Unit, November 2005, p.20.

## POVERTY AND INEQUALITY

Although Guatemala's per capita income places it solidly in the lower-middle-income category, it does face significant challenges in terms of poverty and inequality. In 2000, the last year for which data are available, 56.2 percent of Guatemalans lived below the national poverty line. This is significantly above the 40.6 percent regression benchmark—which estimates the poverty levels that a country of Guatemala's characteristics should have—and the LMI-LAC rate of 37.5 percent (Figure 2-2).

Figure 2-2

*Poverty Headcount for Guatemala and Comparator Countries, according to National Poverty Line, Most Recent Year*



A key factor in understanding the poverty equation in Guatemala is the difference in poverty rates between indigenous and nonindigenous citizens. About 39 percent of Guatemalans identify themselves as indigenous. In 2000, the poverty headcount for indigenous Guatemalans was 74 percent, while nonindigenous Guatemalans had a poverty headcount of 38 percent (virtually identical to the LMI-LAC average). In the same year, the percentage of indigenous Guatemalans living in extreme poverty was 24.3 percent, compared to 6.5 percent of nonindigenous Guatemalans.<sup>12</sup>

A broader measure of poverty is the UNDP Human Poverty Index (HPI), which is a composite index measuring three dimensions of human development on a scale of 0 (no deprivation) to 100

<sup>12</sup>Furthermore, poverty among different indigenous groups varies widely. For example, some 72 percent of the Q'eqchi' are extremely poor, while only 37 percent of the K'iche and the Kaqchikel fall into this category. (Gillette Hall and Harry Anthony Patrinos. *Indigenous Peoples, Poverty and Human Development in Latin America: 1994-2004*. World Bank. May 2005).

(extreme deprivation).<sup>13</sup> Guatemala scored 22.9—not bad by global standards, although somewhat worse than the regression benchmark (17.1) and quite a bit worse than the scores of Chile (3.7) and Costa Rica (4.0). This score converts into a ranking of 43rd among the 94 developing countries considered—squarely in the middle. Chile finished third and Costa Rica fourth.

A recent World Bank study reported that close to one in four Latin Americans lives on less than \$2 per day.<sup>14</sup> In Guatemala, according to the base data for the UNDP HPI, 37.4 percent of people live on less than \$2 a day and 13.5 percent of Guatemalans live on less than \$1 a day.<sup>15</sup> Unsurprisingly, 23 percent of Guatemalans fall below the minimum required dietary energy consumption. By contrast, only 2.0 percent of Chileans and 0.8 percent of Costa Ricans live on only \$1 a day, and only 4 percent in both countries fall below the minimum required energy consumption.

Latin America has one of the most unequal distributions of income. With a Gini coefficient of 58.3, Guatemala has the second-worst income distribution of any country in Latin America, exceeded only by that of Brazil.<sup>16</sup> In 2002, 59.5 percent of income accrued to the richest 20 percent of Guatemalans, while only 2.9 percent of income accrued to the poorest 20 percent. Interestingly, Chile's inequality numbers are not significantly different from Guatemala's, with 62.2 percent of income going to the top 20 percent, and 3.3 percent accruing to the bottom 20 percent. By contrast, Costa Rica, long known to have one of the lowest levels of inequality in the region, saw 54.8 percent of income accrue to the upper 20 percent in 2000, while 3.9 percent of its income accrued to the poorest 20 percent (Figure 2-3).

The data on poverty and inequality underscore the difficulty of the development challenge in Guatemala. Clearly, the economic situation of the lower 50 percent of the Guatemalan population will need to improve if the country's dismal social development indicators are to improve. Donors and policymakers will need to support initiatives that focus concurrently on reducing social exclusion and increasing opportunities for wealth creation in the poorer socioeconomic segments. Given the disproportionately high levels of poverty among Guatemala's indigenous population, donor initiatives should consider paying special attention to the needs of these communities.

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<sup>13</sup> The three dimensions are (1) long and healthy life; (2) knowledge (literacy); and (3) decent standard of living. The HPI is a subindicator of UNDP's Human Development Index. For a full cross-country breakdown, see [http://hdr.undp.org/reports/global/2003/indicator/indic\\_16\\_1\\_1.html](http://hdr.undp.org/reports/global/2003/indicator/indic_16_1_1.html).

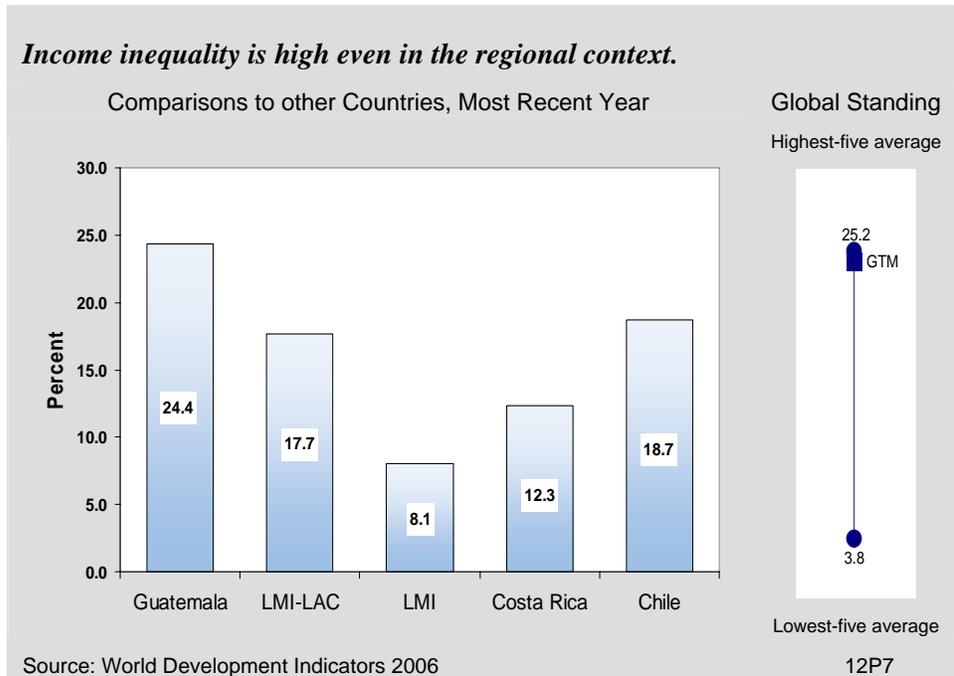
<sup>14</sup> *Poverty Reduction and Growth: Virtuous and Vicious Circles*. Latin America and Caribbean Region. World Bank. February 2006, p.xi.

<sup>15</sup> See the HPI base data at: [http://hdr.undp.org/reports/global/2003/indicator/indic\\_16\\_1\\_1.html](http://hdr.undp.org/reports/global/2003/indicator/indic_16_1_1.html).

<sup>16</sup> *IDB Country Strategy with Guatemala*. Inter-American Development Bank, December 2004, p.2. A Gini coefficient of zero indicates completely even income distribution; highly coefficients indicate highly uneven distribution.

Figure 2-3

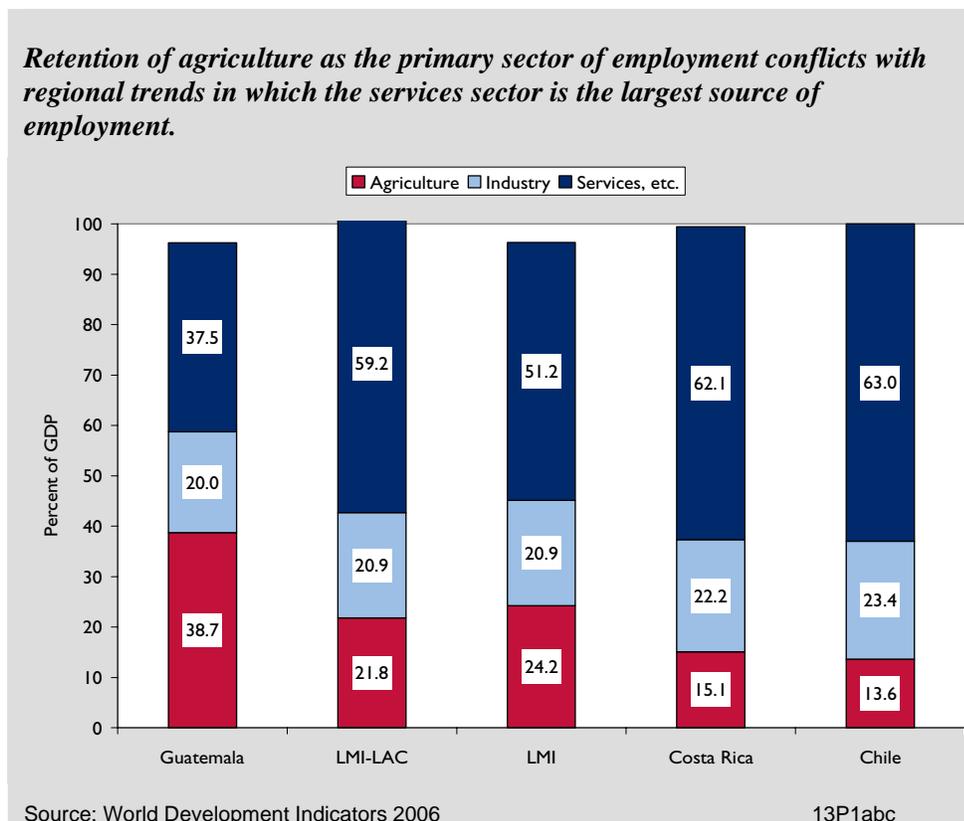
*Ratio of Income Share Accruing to the Richest 20 percent to the Poorest 20 percent*



## ECONOMIC STRUCTURE

Guatemala's economy remains, to a significant degree, based on agriculture. In 2002, the agricultural sector employed 38.7 percent of the labor force, substantially more than the LMI-LAC average of 21.8 percent and much more than in Chile (13.5 percent) or Costa Rica (15.9 percent). Although the official numbers are high, the total number of Guatemalans whose primary productive activity is in agriculture is undoubtedly much higher, because this figure includes only those employed in the formal agricultural sector. The figure does not account for the large rural population engaged primarily in subsistence farming and other informal agricultural activities. This undercounting is problematic because the agricultural sector in Guatemala exhibits low productivity. Agriculture's contribution to value added is calculated at only 22.5 percent of GDP. Although the ratio of labor to share of output in Guatemala's agricultural sector is not out of line with levels found in Chile and Costa Rica or with the regional average, the significant underestimation of those employed in the sector combined with the probable overestimation of agricultural productivity tends to suggest that too many Guatemalans are employed in agriculture. Because agriculture is the primary economic activity, low productivity in agriculture is a major impediment to pro-poor growth; investing in this sector in particular is an effective way to spread efficiency gains across many households (Figure 2-4).

Figure 2-4  
*Labor Force Structures of Guatemala and other Countries, Most Recent Year*

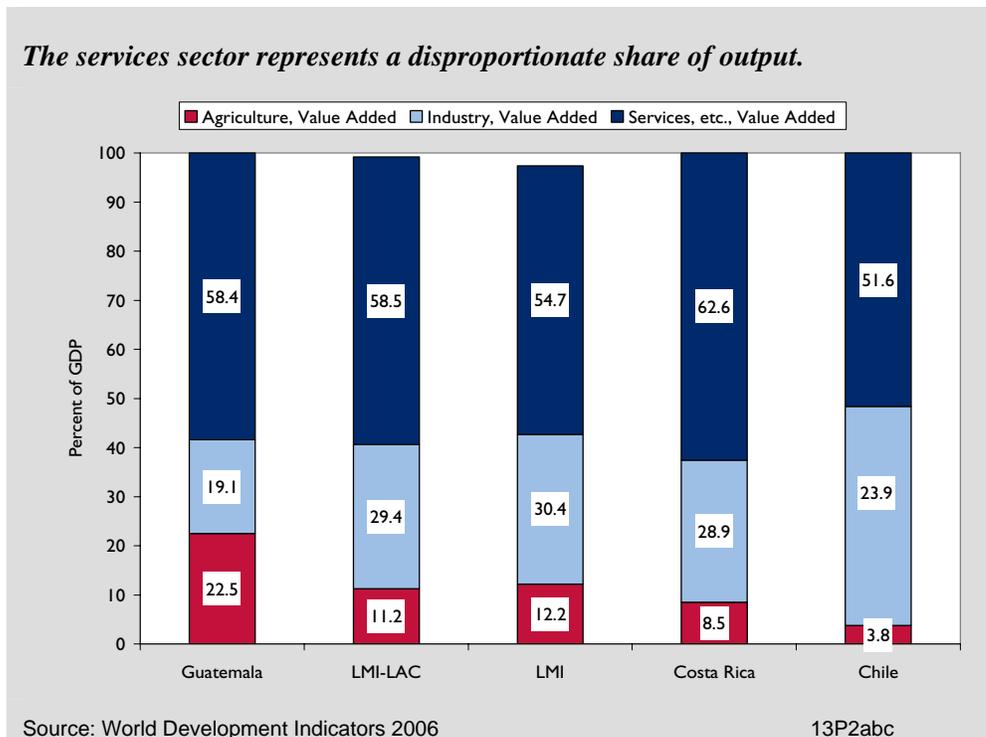


The proportion of the labor force that participates in industry is 20.0 percent, on par with the regional average of 20.9 percent and only slightly below the share in Chile (23.4) and in Costa Rica (22.2). The industrial sector in Guatemala, like agriculture, exhibits relatively low productivity at 19.1 percent value added for 2004, about the same level as its share of the labor force. The statistical benchmark suggests that a country with Guatemala’s characteristics should be producing 27 percent value added in industry. By contrast, Chile, at 44.6 percent, and Costa Rica, at 28.9 percent, are producing much greater percentages of added value in industry, suggesting that industrial sector workers in these countries enjoy significantly greater productivity than similar workers in Guatemala. Investing in new technology, training, and increased productive capacity in the industrial sector is a key component to vitalizing Guatemala’s economy (Figure 2-5).

The services sector in Guatemala is thriving. With 37.5 percent of the labor force, services accounted for 58.4 percent of the value added. Guatemala effectively outproduces Costa Rica (62.6 percent value added) and Chile (51.6 percent value added), because the services sector accounts for a much greater proportion of these countries’ labor force, at 62.1 percent and 63.0 percent respectively. Reproducing the efficiency of the services sector could contribute to the expansion of more traditional sectors such as agriculture and industry.

Figure 2-5

*Output Structure for Guatemala and Comparators, Most Recent Year*



## DEMOGRAPHY AND ENVIRONMENT

In 2005 the Guatemalan population reached 12.7 million.<sup>17</sup> One of Guatemala's most striking demographic features is the proportion of the country's total population that identifies itself as indigenous—one of the largest in Latin America (see Exhibit 2-1).

### Exhibit 2-1

#### *Indigenous Peoples*

The share of the population that identifies itself as indigenous in Guatemala is about 39 percent of the total population, while it is only 3 percent in Chile and 1 percent in Costa Rica. Because of the complex history of indigenous and nonindigenous relations, the large indigenous population makes Guatemala's socioeconomic challenges fundamentally different than those of largely homogenous Chile and Costa Rica. The importance of the indigenous reality in Guatemala manifests itself in many ways—

from more limited access to health services to the need (not always fulfilled) for education in native languages to scant access to credit for buying property or establishing businesses to poor transport linkages between indigenous areas and the rest of the country. The UNDP warns, "[T]he country will become increasingly hard to govern" if the government does not integrate indigenous peoples more into mainstream Guatemalan society.<sup>18</sup>

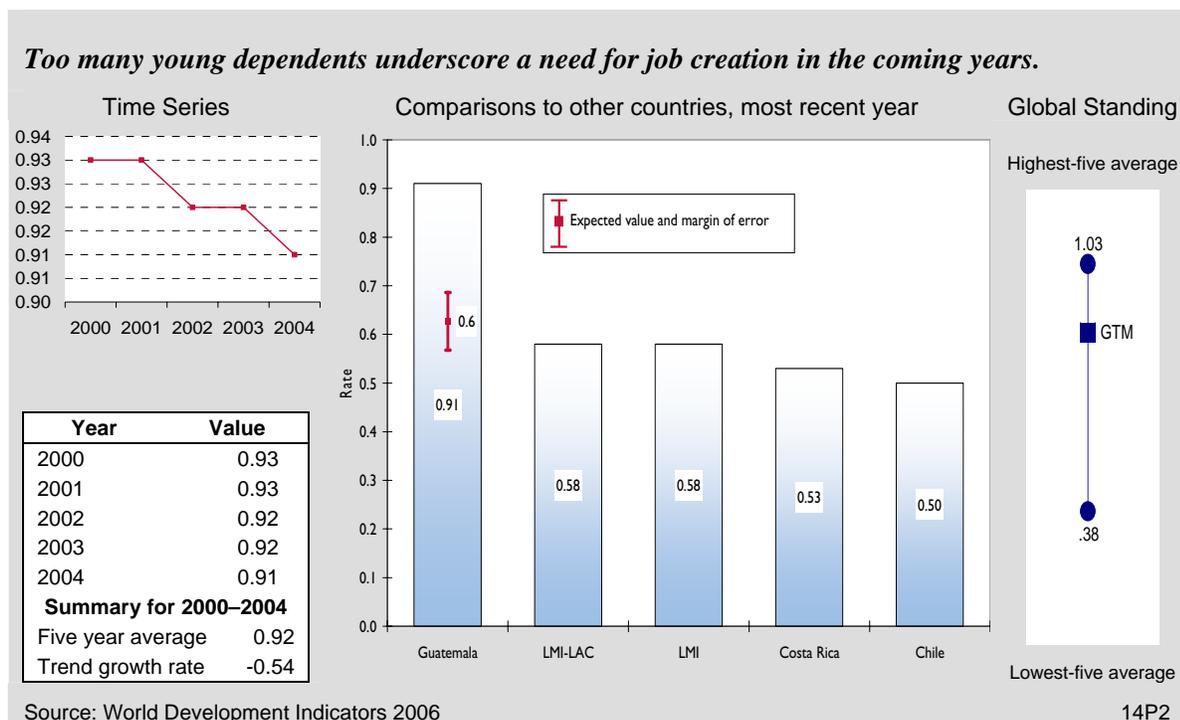
<sup>17</sup> Based on information received from the LAC Bureau following consultations on the US Census International Program data.

<sup>18</sup> *Diversidad étnico-cultural: La ciudadanía en un Estado plural. Informe Nacional de Desarrollo Humano 2005*. Guatemala: United Nations Development Program. December 2005.

Guatemala had an average yearly population growth rate in the period between 2000 and 2004 of 2.4 percent. Its population growth is high when compared to all benchmarks, including the LMI-LAC average (1.5 percent), Costa Rica (1.8 percent), Chile (1.1 percent), and the statistical regression results (1.7 percent). High population growth is the result of factors specific to the poverty cycle, such as low educational attainment, limited access to public health services, lack of social security systems, and pronounced gender inequality. Unchecked population growth perpetuates the poverty cycle by creating an additional burden to already overtaxed social services, increasing the burden on households to provide basic sustenance, and generating a greater demand for employment in conditions of scarce supply.

Guatemala’s high population growth is coupled with a high age dependency rate of 0.91, meaning that for every working individual are 0.91 persons dependent on their income. By contrast, Chile has an age dependency rate of 0.50 and Costa Rica a rate of 0.53, and the LMI-LAC regional average is 0.58. Even the statistically predicted benchmark is only 0.60. Guatemala’s high dependency ratio is a consequence of too many young dependents rather than a large elderly population. This translates into a great need for job creation in the coming years as this younger generation enters the labor force (Figure 2-6).

Figure 2-6  
Age Dependency Rate

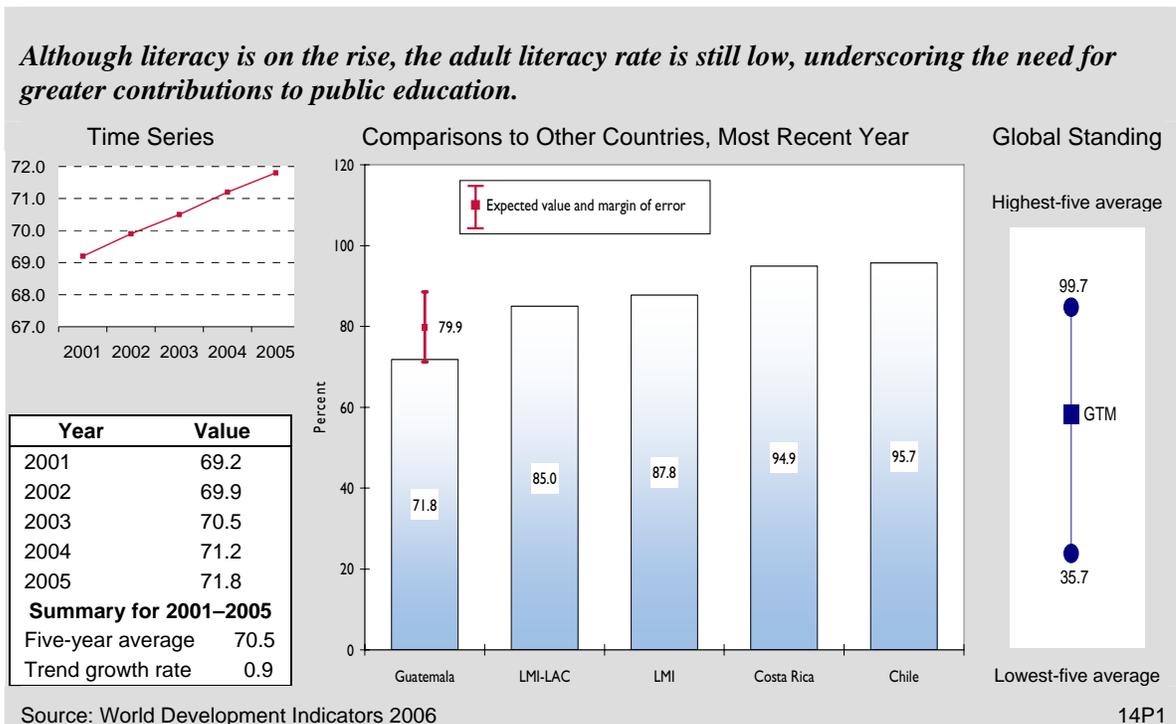


Guatemala’s demographic landscape is also characterized by a lower-than-predicted urbanization rate—46.8 percent compared with the estimated 52.1 percent. This is due in part to geographic isolation caused by Guatemala’s poor road network, which in turn, results from the country’s

challenging, variegated topography. The longstanding social exclusion of the indigenous poor, who tend to live in rural areas, also plays a role.<sup>19</sup>

Guatemala's adult literacy rate of 71.8 percent in 2005 is low compared with the statistical benchmark of 79.9 percent and figures for Chile (95.7 percent) and Costa Rica (94.9 percent). Ending widespread illiteracy is fundamental to creating growth because education is an essential component to human capital development and contributes to gender equality, which in turn contributes to sustainable population growth (Figure 2-7).

Figure 2-7  
Adult Literacy Rate



Guatemala also exhibits poor environmental stewardship, with an Environmental Sustainability index of 44 for 2005.<sup>20</sup> The component factors that contribute the most to Guatemala's poor environmental sustainability score include poor air and water quality, vulnerability to natural disasters, and population stress. The best-documented and arguably the most crucial single environmental challenge facing Guatemala is deforestation in the Peten region in the northern part of the country.<sup>21</sup> The deforestation process, driven by complex socioeconomic factors (including population stress), is not only environmentally disastrous, but threatens to weaken, in the medium term, the drawing power of Tikal, the world-famous Mayan ruins that are one of

<sup>19</sup> *Poverty In Guatemala* World Bank Report No. 24221-GU, p.59.

<sup>20</sup> The Environment Sustainability Index scores from 0 (for poor) to 100 (excellent).

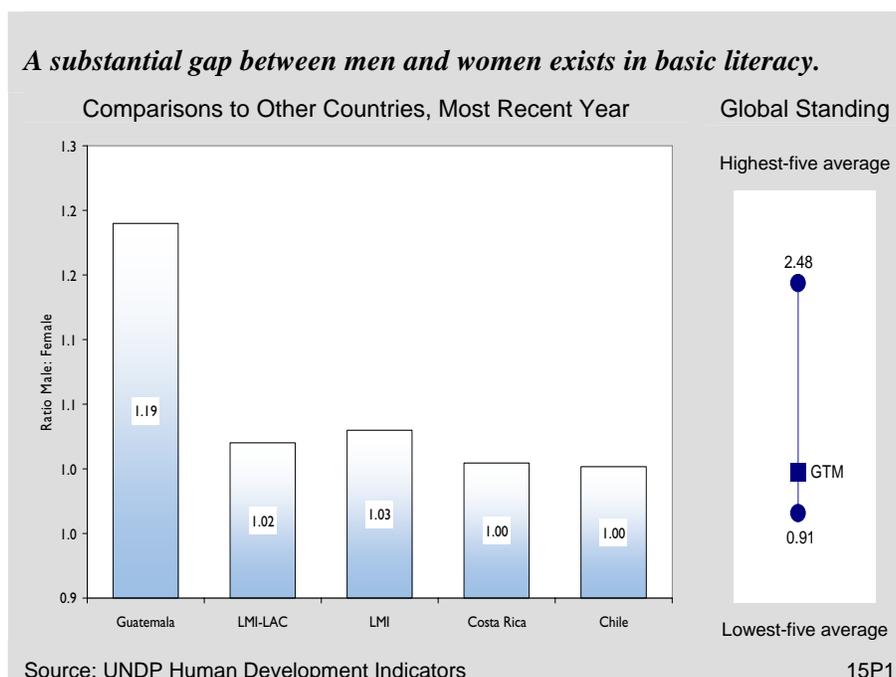
<sup>21</sup> For visual evidence of the deforestation process in Peten, see *Time-Series Forest Change/Land Use Conversion and Socio-Economic Driving Factors*, a project sponsored by, inter alia, NASA, the University of Maine, and USAID: <http://www.ume.maine.edu/~MIAL/lcluc/home/home.htm>.

Guatemala’s principal tourist attractions. Policies that encourage stewardship of the environment are essential for maintaining precious natural resources (including the populace) and sustainable economic growth.

## GENDER

Gender equality is a prerequisite for pro-poor growth. Women who are able to fulfill their productive potential in the paid economy tend to redistribute gains throughout the household, improving the welfare of all household members in the process. This tends to result in lower birth rates and better health. Guatemala grossly underperforms on indicators of gender equality, which underscores a strong and persistent bias against women.<sup>22</sup> In 2004 the ratio of male-to-female adult literacy was 1.19, while the ratio of male-to-female gross enrollment was 1.10. The regional averages for these figures were 1.02 and 0.98 respectively, indicating that women in Guatemala do not have good, consistent access to education (Figure 2-8).

Figure 2-8  
Male-to-Female Adult Literacy Rate



Assistance that augments efforts to educate women will reap immediate gains in terms of human capital development and welfare. Considering the high maternal mortality rate (see Health section) it would appear that there are significant gender disparities in the provision of health care. Persistent gender inequalities stymie growth by limiting the productive capacity of half the population. Donor support for programs that promote women’s access to education, health care,

<sup>22</sup> The World Bank report Poverty in Guatemala systematically outlines the presence of gender discrimination in the labor market (i.e., relegation to the informal sector and therefore lower wages) and the wage structure (lower wages overall).

employment, and political life work to correct gender disparities and facilitate improved overall economic performance.

# 3. Private Sector Enabling Environment

This section reviews indicators for components of the enabling environment that encourage rapid and efficient growth of the private sector. Sound fiscal and monetary policies are essential for macroeconomic stability, which is a necessary (though not sufficient) condition for sustained growth. A dynamic market economy also has institutional foundations, including secure property rights, an effective system for enforcing contracts, and an efficient regulatory environment that does not impose undue barriers on business activities. Financial institutions play a major role in mobilizing and allocating savings, facilitating transactions, and creating instruments for risk management. Access to the global economy is another pillar of a good enabling environment, because the external sector is a central source of potential markets, modern inputs, technology, and finance, as well as competitive pressure for efficiency and rising productivity. Equally important is the development of the physical infrastructure to support production and trade. Finally, developing countries need to adapt and apply science and technology to attract efficient investment, improve competitiveness, and stimulate productivity growth.

## FISCAL AND MONETARY POLICY

The Guatemalan government has demonstrated sound fiscal and monetary policies<sup>23</sup> in recent years despite uncertain political conditions, increasing global oil prices, and fluctuating international prices for coffee, the country's largest commodity export.<sup>24</sup> The fiscal deficit has remained in check while inflation has remained in the single digits.

Guatemala's inflation rate for 2005 was 9.1 percent, high compared to the previous four years, when inflation ranged between 5.6 and 8.1 percent. According to the Economist Intelligence Unit, persistent increases in global oil prices coupled with improving domestic conditions and the one-

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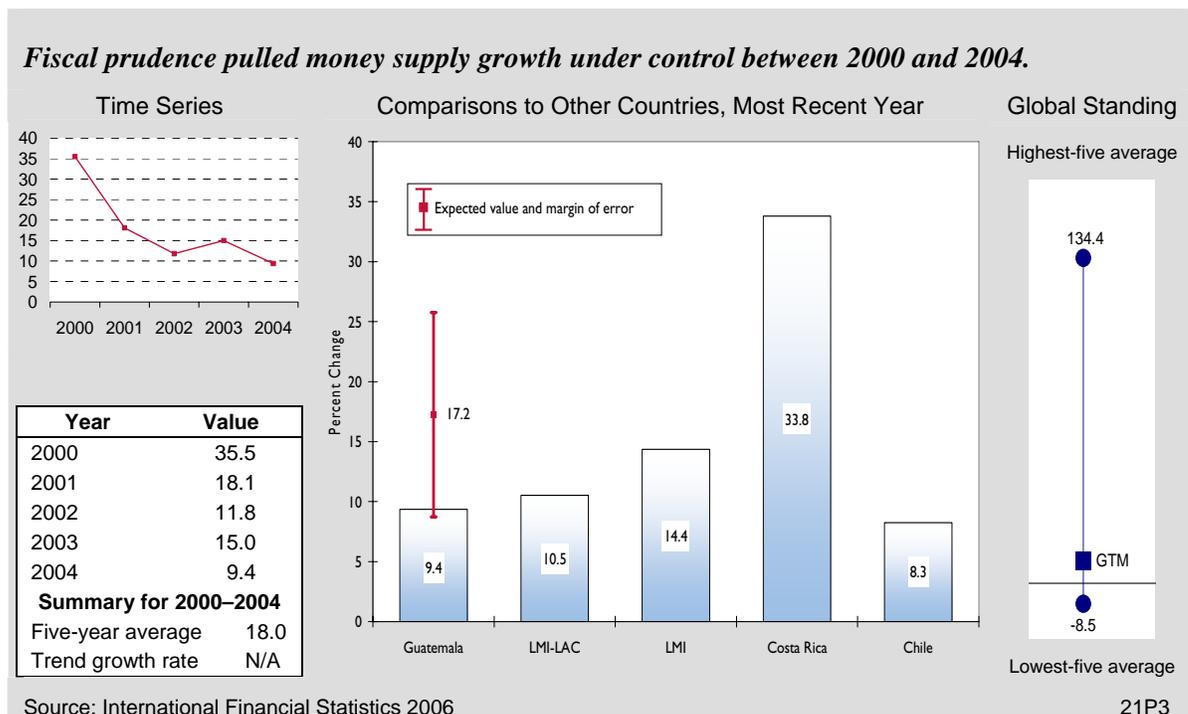
<sup>23</sup>In 2005, the World Development Indicators adopted a new system for classifying fiscal data, although most developing countries still use the old classification. WDI therefore has fiscal data for very few developing countries; because of the limited sample size, most of the group averages derived from WDI are not meaningful. In this section, comparisons are based on absolute standards or benchmarks derived from 2004 WDI data as well as figures for Chile and Costa Rica.

<sup>24</sup> Between 2000 and 2001, Guatemala's coffee exports plummeted from \$572 million to \$301 million. The value of Guatemala's coffee exports continued to decline in 2002, hitting \$269 million, half the value of 1999 exports (\$588 million). Prices began to recover in 2003 and 2004 but remained well off the levels reached at the beginning of the decade. Although drought was the key driver of the decline, enhanced international competition and a greater demand for differentiation are also changing the nature of the global coffee market. See Guatemala: Statistical Annex. International Monetary Fund. October 2005, Table 32.

off effect of the repairs from Tropical Storm Stan, which hit the country in October 2004, drove inflation above 9 percent for the first time.<sup>25</sup>

Growth in broad money supply showed signs of slowing in 2004, expanding by 9.4 percent, compared with the 18.6 percent average annual growth between 1999 and 2003. Guatemala compares favorably in this area to Costa Rica (33.8 percent) and exceeds the regression benchmark (17.2 percent) (Figure 3-1). Declining money supply growth is largely due to restrictive government spending in concert with central bank sterilization efforts, principally driven by the massive increase in remittance inflows in recent years that have forced down inflationary pressures (see External Sector section). Net credit to the government in 2004 was negative at -55.8 percent of money supply growth. To Guatemala's credit, much of the money supply growth has been fueled by the private sector, with 93.6 percent of growth in 2004 coming from the private sector.<sup>26</sup>

Figure 3-1  
*Growth in the Money Supply*



The fiscal deficit averaged 1.5 percent of GDP annually from 2000 to 2004, peaking at 2.3 percent in 2003, but recovering in 2004 to 0.9 percent. According to the IMF, the 2003 surge was the result of mostly one-time factors. By contrast, in 2004 the LMI-LAC average deficit was 2.5 percent, as was the statistical regression. Chile ran a surplus in 2004 of 2.2 percent, while Costa Rica ran a 1.3 percent deficit.

<sup>25</sup> *Country Report: Guatemala*, The Economist Intelligence Unit, p.11.

<sup>26</sup> The large proportion of money supply growth driven by the private sector should not be taken as an indication of private sector growth because, as stated previously, overall money supply growth is declining.

Government revenue as a share of GDP was 10.2 percent in 2005 (See Exhibit 3-1), whereas the statistical benchmark suggests that Guatemala's government revenue should be near 18.1 percent of GDP. Revenue collection is below the LMI-LAC average (16.2 percent), and yet further below the levels of Chile (22.3 percent) and Costa Rica (22.5 percent). Despite its laudable fiscal management, a weak revenue base has restricted the Guatemalan government's ability to increase social spending. Government expenditure as a percent of GDP was only 11.7 percent for 2005, compared with 18.4 percent in Chile and 22.7 percent in Costa Rica. In other words, the Guatemalan government does not collect enough revenue and does not spend enough on public goods to meet the challenges that the country faces (Figure 3-2).

### Exhibit 3-1

#### *Taxation vs. the Constitution*

Article 243 of the Guatemalan Constitution (as reformed in 1993) establishes the "Principle of the Capacity to Pay." It states the "tax system must be just and equitable" and that "tax laws will be structured in conformity with the principle of the capacity to pay." In addition, "confiscatory taxes ... are prohibited." Although this article was designed to promote tax fairness, in practice it has been used by powerful groups in society to reduce their tax burden. Between 2001 and 2003, the Constitutional Court received more than 50 appeals to eliminate, clarify, or reduce taxes based on Article 243. Although most appeals have been rejected, the Constitutional Court has ruled against the state in a number of cases. In 2003, the court eliminated the minimum corporate tax and rejected the elimination of the VAT deduction against taxable

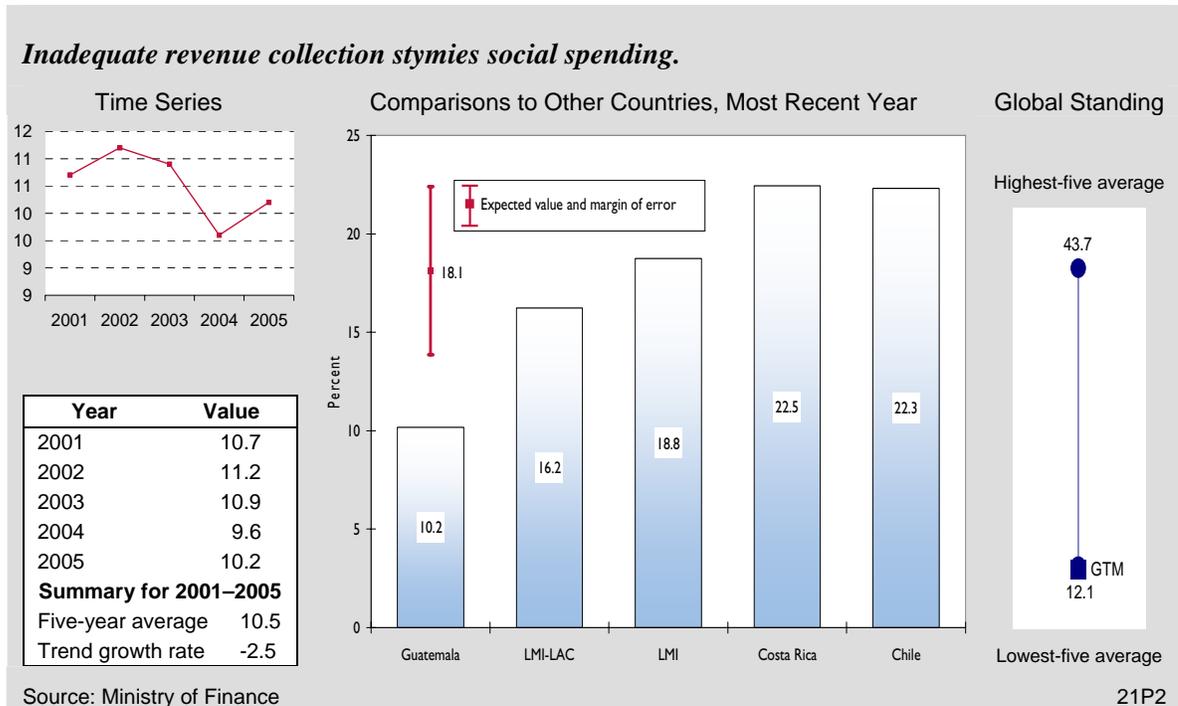
income. In late 2004, the court issued an injunction against the excise tax on fuel. These decisions threaten to reduce tax revenue by 12 percent per year. Not only does Article 243 create an unpredictable tax environment, it makes reaching the 12 percent revenue target established in the peace accords exceedingly difficult. Although the situation is significantly better than in the early 1990s when the tax burden was just 7.4 percent, revenues were still only 10.2 percent of GDP in 2005, low by any meaningful standard. The Berger Administration is well aware of these tax collection challenges and is endeavoring to correct this imbalance through a variety of policy avenues. It is hoped that the percentage of revenues collected will increase over the medium term.

Guatemalan government revenue comes primarily from taxes on goods and services (54.1 percent in 2005) and income, profit, and capital gains (24.3 percent in 2005). However a large portion of revenue (14.9 percent in 2005) is collected from taxes on international trade. Guatemala therefore will face increasing pressure to find alternative ways to collect revenue to compensate for the losses due to diminishing tariffs as CAFTA-DR is phased in. National policymakers may find that this alternative can be applied best in the context of a broader tax reform process.<sup>27</sup>

Despite its taxation challenges, Guatemala's excellent fiscal discipline and low public debt give the government some fiscal space to increase spending to enhance human capital development, social stability, and international competitiveness. If carried out prudently, enhanced public expenditure in targeted areas would improve the conditions for growth and wealth creation.

<sup>27</sup> The IMF and the Inter-American Development Bank have been working extensively for the past few years with the countries of Latin America and the Caribbean on the revenue and tax reform implications of hemispheric and subregional free trade. For a good overview of the implications of CAFTA-DR, see Chiara Bronchi and Dale Chua. *Trade Liberalization and Tax Coordination*. Central America: Global Integration and Regional Cooperation (Markus Rodlauer and Alfred Schipke (eds.)). IMF Occasional Paper 243, July 1, 2005, Chapter 3. <http://www.imf.org/external/pubs/ft/op/243/243ch3.pdf>.

Figure 3-2  
 Government Revenue, Percent GDP



## BUSINESS ENVIRONMENT

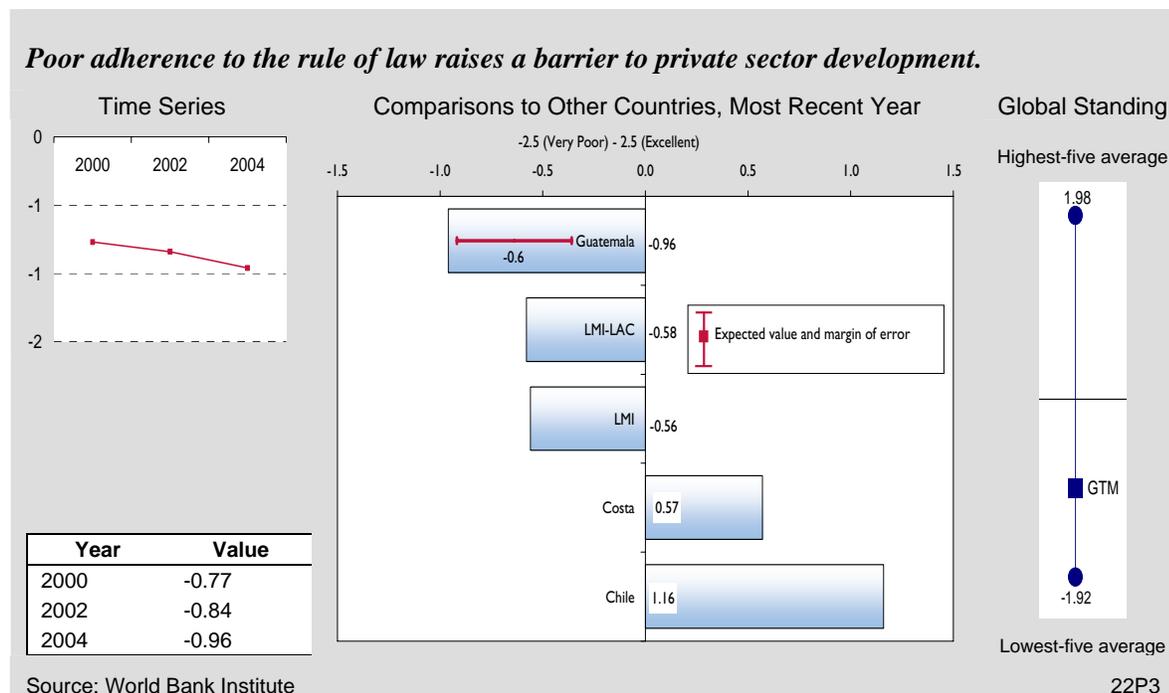
Institutional barriers to doing business, including corruption in government, are critical determinants of private sector development and prospects for sustainable economic growth. Guatemala underperforms on many key indicators, compared to both the regression benchmarks and the LMI-LAC average. In short, there is a great need to remove impediments to doing business for doing so, especially with the intensified competitiveness challenges arising from CAFTA-DR.

Two challenges to improving Guatemala's business environment are inter-related: greater adherence to the rule of law and reducing crime and violence. Virtually all reports that discuss the business environment in Guatemala cite these factors as impediments to enhanced business activity. In the World Bank Institute Rule of Law index, which ranges from -2.5 (poor) to +2.5 (excellent), Guatemala scored a -0.96, far worse than the regression benchmark (-0.6) and the LMI-LAC average (-0.58). Moreover, Guatemala's performance in the rule-of-law area is far worse than that of Chile (+1.16) or Costa Rica (+0.57). Obtaining reliable data on violent crime is complicated for relatively low-crime countries such as Chile and Costa Rica, but a number of Guatemala-specific reports, however, paint a stark picture of the country's challenges in this area. The 2006 State Department Investment Climate Statement on Guatemala noted that large firms report that providing security, including the security of shipments, adds as much as 25 percent to the variable cost of doing business in Guatemala.<sup>28</sup> A World Bank report, citing a 2003 survey, notes that Guatemalan firms reported spending an average of 7 percent of their total costs on

<sup>28</sup> 2006 *Investment Climate Statement – Guatemala*. United States Department of State. <http://www.state.gov/e/eb/afd/2006/61984.htm>.

security. Material losses associated with violent acts and their prevention, both to families and businesses, amount to close to 6.8 percent of GNP (Figure 3-3).<sup>29</sup>

Figure 3-3  
*Rule of Law Index*



Another large challenge facing Guatemala is corruption. In Transparency International's 2005 Corruption Perceptions index, Guatemala scored 2.5 of 10 (10 being the lowest level of corruption), ranking it 117th of a possible 158.<sup>30</sup> By contrast, Chile received a 7.3 and Costa Rica a 4.2.<sup>31</sup> Guatemala achieved almost the same score in the World Bank Institute index on controlling corruption, receiving a 27.1 percentile ranking in 2004, down from 27.3 in 1998.<sup>32</sup> The consistently poor ranking in the Control of Corruption category has kept Guatemala from benefiting from the Millennium Challenge Account (MCA). Guatemala also received failing grades on all Ruling Justly indicators and most Investing in People indicators.<sup>33</sup>

<sup>29</sup> *Guatemala Country Economic Memorandum*, World Bank, p. 84.

<sup>30</sup> Guatemala tied with Afghanistan, Bolivia, Ecuador, Guyana, Libya, Nepal, Philippines, and Uganda. See the full 2005 rankings at: <http://www.transparency.org/cpi/2005/cpi2005.sources.en.html>.

<sup>31</sup> Quantitative and anecdotal evidence suggests that the figure for Costa Rica may not be accurate. At the time the survey was being conducted, Costa Rica was in the midst of a major corruption scandal that resulted in jail time for two former presidents and disgrace for a number of other senior officials. Thus, one could posit that survey respondents were especially sensitive to corruption and that this year of data was an outlier.

<sup>32</sup> The World Bank Institute data on Control of Corruption are particularly important to Guatemala and other developing countries because it is used by the Millennium Challenge Corporation as the official indicator for assessing corruption in candidate countries. For a full set of corruption and other governance indicators, see [http://info.worldbank.org/governance/kkz2004/sc\\_chart.asp](http://info.worldbank.org/governance/kkz2004/sc_chart.asp).

<sup>33</sup> See Guatemala's 2006 rankings at: <http://www.mcc.gov/countries/rankings/FY06/LMIC/index.shtml>.

Rule of law and corruption challenges certainly contribute to Guatemala's poor performance in the ease of doing business.<sup>34</sup> On a scale of 1 to 155 (1 being the easiest), Guatemala finished in 109th position in the 2005 survey. By contrast, Chile finished 25th and Costa Rica 89th.<sup>35</sup> Guatemala also did not do well on the Regulatory Quality index, which ranges from -2.5 (poor) to +2.5 (excellent), with a score of -0.07 in 2004. Once again, comparator countries Chile (+1.62) and Costa Rica (+0.67) are well ahead of Guatemala. More troubling is the fact that Guatemala's 2004 score was a significant decline from +0.46 in 2000, indicating that the country seems to be moving in the wrong direction in this area.

On the transaction side of doing business, Guatemala, in general, has superb rules on the books for key procedures, but the rules appear to be poorly applied. Starting a business in Guatemala requires 15 procedures, only slightly above the LMI-LAC average of 12.5 procedures. Registering property in Guatemala requires only five procedures, fewer than in Chile or Costa Rica (each with six). Enforcing a contract in Guatemala requires 37 procedures, the same as the LMI-LAC average and only slightly more than in Costa Rica (34). The data on the number of formal procedures constitute a bright spot, because it shows that Guatemala is more or less in line with its benchmarks, a significant achievement given the high standards set by Chile and Costa Rica.

But the time it takes to complete these procedures is another story. It takes an average of 39 days to start a business in Guatemala, more than in Chile (27 days), but half the time required in Costa Rica (77 days) and well below the LMI-LAC average (56 days)—not bad on the whole. The number of days required to register property shows a different story, however. Completing the five required procedures for property registration in Guatemala took an average of 69 days, more than double the time required to complete this process in Chile (31 days), more than three times the time required in Costa Rica (21 days), and one-third more than the LMI-LAC average. The most dramatic and problematic divergence in the indicators is in the time required to enforce a contract. In Chile, it takes an average of 305 days to enforce a contract; in Costa Rica, the enforcement process averages 550 days; and the LMI-LAC average is 457 days. However, in Guatemala, enforcing a contract takes an average of 1,459 days—or 4 years (Figure 3-4)!<sup>36</sup>

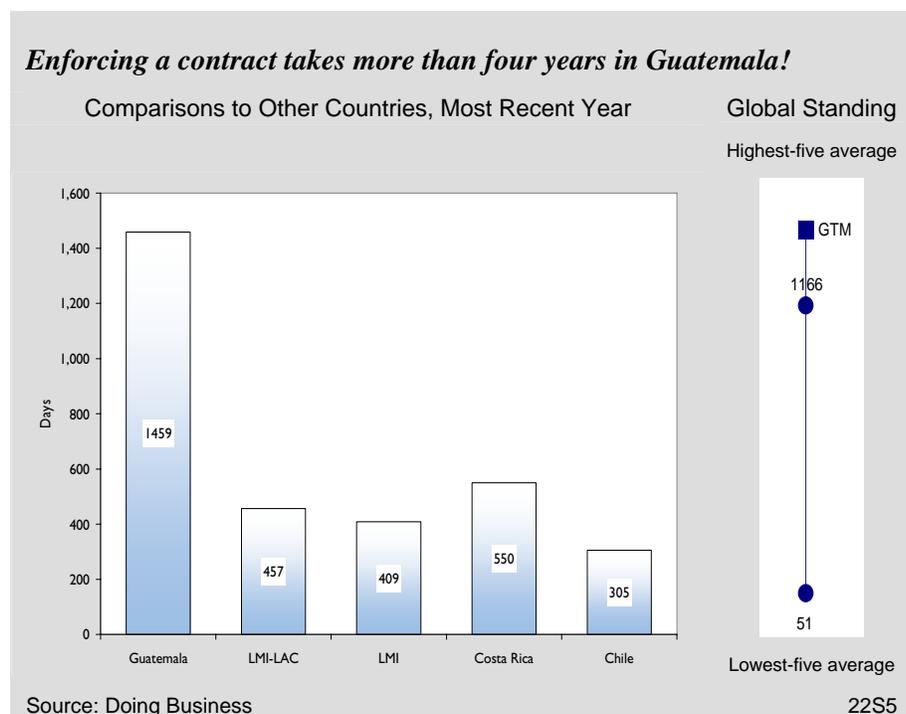
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<sup>34</sup> World Bank Doing Business rankings are widely cited, in part because they helped fill a data void. Questions have been raised about the accuracy of the data, however. The authors of this report were told that in Guatemala, for example, that a very limited number of lawyers were surveyed. Therefore, the results, including the dramatic results on time required to enforce a contract, need to be treated with caution and presented with a caveat about the perils of small sample sizes. In short, Doing Business indicators for Guatemala may not be entirely representative.

<sup>35</sup> Quantitative and anecdotal evidence suggests that Costa Rica's poor ranking may not be accurate. At the time the survey was being conducted, Costa Rica was in the midst of a major high-level corruption scandal that resulted in the jailing of two former presidents and the disgracing of a number of senior officials. The data indicate that doing business in Mexico, Argentina, and Russia is easier than in Costa Rica, which is considered highly unlikely by those with knowledge of markets in these countries. Thus, one could posit that this year of data was an outlier.

<sup>36</sup> A number of concrete recommendations on strengthening the contracts system are set forth in *Trade and Commercial Law Assessment – Guatemala*. USAID, January 2005, p. IV-1-IV-7. [http://www.bizlawreform.com/country\\_assess/GuatemalaTCLA.pdf](http://www.bizlawreform.com/country_assess/GuatemalaTCLA.pdf).

Figure 3-4  
Time to Enforce a Contract



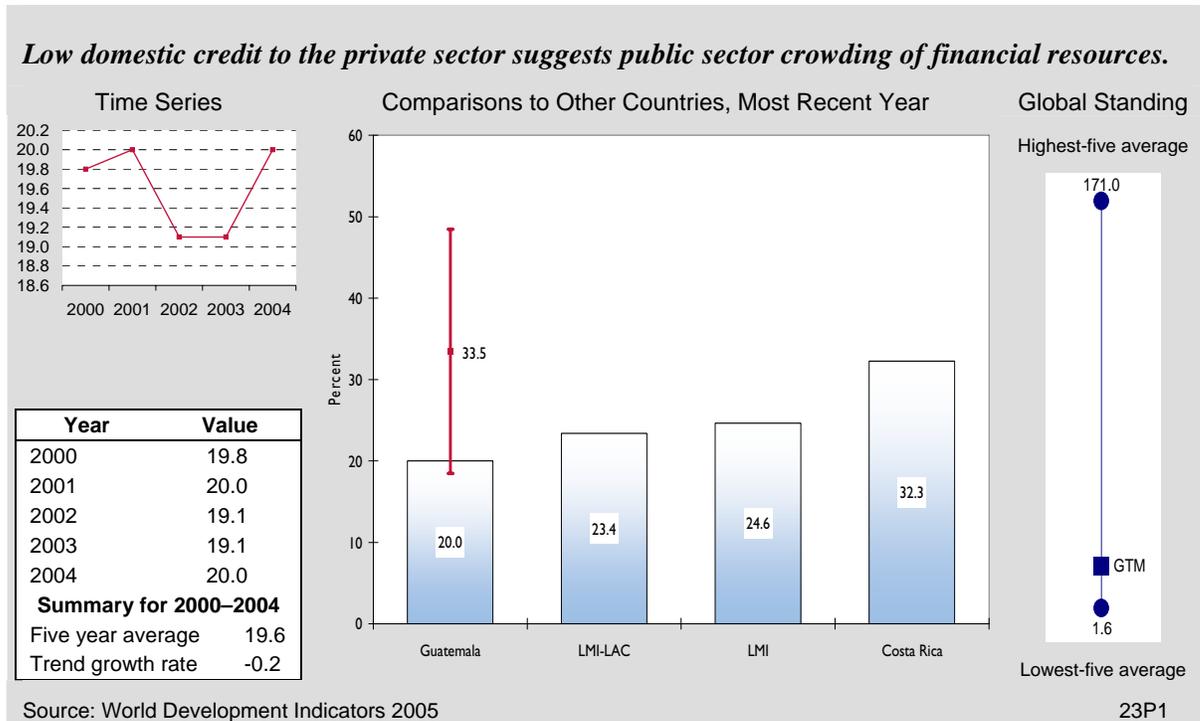
Improving the business environment would appear to be a top priority for Guatemala and an area in which it can benefit from donor assistance. Foreign investors and traders will carefully compare the business climates of the CAFTA-DR countries when deciding where to locate or expand a business. Guatemala needs to become competitive in this area if it hopes to benefit from the agreement to the maximum degree. Programs that donors may wish to consider include (1) anticorruption; (2) judicial strengthening; (3) strengthening regulatory performance; and (4) anti-violent crime and anti-gang programs (targeting the international gangs that have become a big problem in Guatemala).

## FINANCIAL SECTOR

A sound and efficient financial sector is key to mobilizing savings, fostering productive investment, and improving risk management. Guatemala's financial sector is underdeveloped as a conduit for providing capital for productive investments, particularly for small and medium-sized enterprises.

Domestic credit to the private sector was 20.0 percent of GDP in 2004, approximately 13 percentage points below the statistically predicted value of 33.5 percent and below Costa Rica's 32.3 percent and Chile's 63.1 percent. This means that less than one-fifth of the credit disbursed by banks and other financial institutions in Guatemala is directed toward the private sector. Guatemala's stock market, the *Bolsa de Valores Nacional*, is small and underdeveloped, with a capitalization rate of 1.1 percent of GDP in 2001. Financial deepening could prove valuable in supporting growth of the private sector in Guatemala (Figure 3-5).

Figure 3-5  
*Domestic Credit to the Private Sector, percent GDP*



The inefficiencies in the Guatemalan banking sector undoubtedly impede small and medium-sized enterprises' access to credit. In 2003, for example, the interest rate spread of 9.6 effectively served as a 9.6 percent penalty on borrowers. While larger firms have the depth to absorb this cost, many small and medium-sized businesses do not and are priced out of the credit market. The high cost to create collateral puts small and medium-sized businesses at a further disadvantage—in 2004, this cost reached 15.0 percent of per capita income. Although this number is not high for LMI-LAC, with a regional average of 23.7 and Costa Rica registering 16.2 percent (Chile registered 5.3 percent), the cost remains an important impediment to firms seeking capital for startup or expansion. On the positive side, real interest rates in Guatemala were 5.2 percent in 2004, down from 8.8 percent in 2003 and a high of 13.2 percent in 2000.

The Berger Administration has recognized the high costs imposed by the financial system on small and medium-sized businesses and is introducing legislation to make obtaining credit much easier for small businesses. Reforms include laws governing microfinance institutions and making moveable property eligible as security for loans. Donors should observe the progress of these proposals as they move through Congress and offer support to their implementation if necessary. Getting investment capital into the hands of small and medium-sized businesses is fundamental to the development process.

## EXTERNAL SECTOR

Fundamental changes in international commerce and finance, including reduced transport costs, advances in telecommunications technology, and lower policy barriers, have fueled a rapid increase in global integration in the past 25 years. The international flow of goods and services, capital, technology, ideas, and people offers great opportunities for Guatemala to boost growth

and reduce poverty by stimulating investment, productivity, and efficiency; providing access to broader markets and new ideas; and expanding the range of consumer choice. Globalization also necessitates that countries adopt institutions, policies, and regulations that take full advantage of international markets while developing effective approaches to cope with adjustment costs and establish systems for monitoring and mitigating associated risks.

## CAFTA-DR

The most significant manifestation of the integration process in the case of Guatemala is the United States–Central America/Dominican Republic Free Trade Agreement. CAFTA-DR guarantees Guatemala tariff- and quota-free trade with the largest consumer market in the world, the United States. In exchange, Guatemala agrees to reduce barriers to imports of goods and services on an agreed schedule. The United States and its CAFTA-DR partners also commit to common rules governing the treatment of foreign investment and the protection of intellectual property rights as well as to rules for determining country of origin. The CAFTA-DR agreement also serves as a tool for regime-building by establishing common anticorruption commitments akin to the internationalization of the Foreign Corrupt Practices Act and by establishing a methodology for enhancing labor rights in Central America and the Dominican Republic. In short, CAFTA-DR is a multifaceted agreement that establishes a comprehensive regime that will govern most aspects of commerce among its six signatory countries.<sup>37</sup>

The entry into force of CAFTA-DR and by extension, the reduction of barriers to trade and investment globally pose tremendous challenges to Guatemala. CAFTA-DR will not only result in increased imports of goods and services from the United States, but also greater intra-Central American competition on both the trade and investment attraction fronts. International firms are likely to consolidate their regional presence, thereby placing a premium on the domestic investment climate that the CAFTA-DR agreement and its Investment Chapter will help to underpin.

A key innovation in the CAFTA-DR agreement is the inclusion of a trade capacity building process. Before negotiations, Guatemala and its fellow CAFTA<sup>38</sup> countries each developed national trade capacity building (TCB) strategies that set forth their needs for negotiating, implementing, and adjusting to the agreement. USTR and USAID led the mobilization of assistance to meet these needs. Donors included U.S. government agencies and departments, international financial institutions, nongovernmental organizations, and private sector firms and

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<sup>37</sup> The full text and more complete summaries of CAFTA-DR are available at: [http://www.ustr.gov/Trade\\_Agreements/Bilateral/CAFTA/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/Section_Index.html).

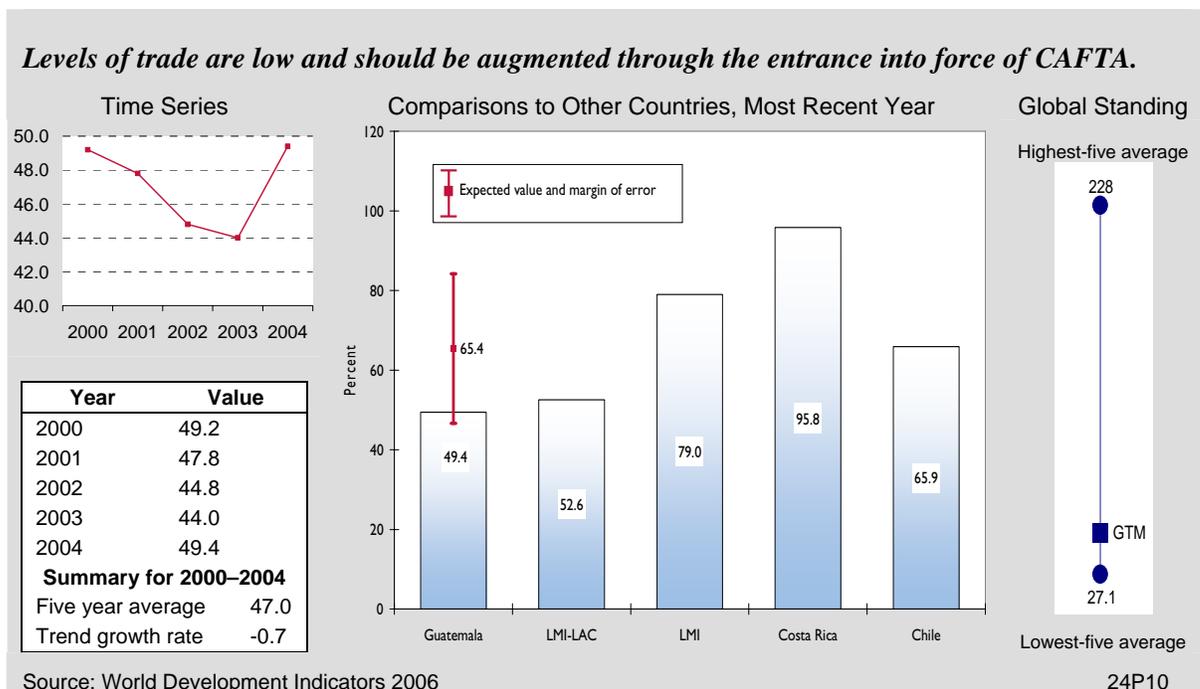
<sup>38</sup> When referring to the negotiating period, it is more accurate to refer to the agreement as simply CAFTA. The agreement was originally negotiated by the five Central American Common Market countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) with the United States between January and December 2003 (through January 2004 in the case of Costa Rica). In August 2003, the United States agreed to a request by the Dominican Republic that the two countries negotiate a “docking agreement” that would allow the DR to become a party to the CAFTA agreement. The US-DR Agreement was negotiated in the first quarter of 2004 and was integrated into the final CAFTA-DR agreement which was announced by the seven countries in August 2004.

organizations.<sup>39</sup> Chapter 19 of CAFTA-DR mandates that the trade capacity building process continue throughout the life of the agreement. Donors should continue to use the TCB channel to assist countries in implementing and adjusting to the CAFTA-DR.<sup>40</sup>

## International Trade Performance

The most common indicator for determining the openness of a country to international trade is the ratio of exports plus imports to GDP. In 2003, when Guatemala negotiated CAFTA, its trade as a percentage of GDP was 44.0 percent, down from a high of 49.2 percent in 2000. This is well below the regression benchmark of 65.4 percent and below the LMI-LAC level of 52.6 percent. Chile, a country that has placed trade at the center of its growth strategy, has a trade to GDP ratio of 65.9 percent. Costa Rica, by contrast, has a trade-to-GDP ratio of 95.8 percent, typical of a small, relatively prosperous country. Indications of declining trade performance are reinforced by Guatemala's results in the Actual and Expected Trade Size index (a scale of 0 [poor] to 10 [excellent]). Guatemala posted a 1.8 in 2003, down from 2.9 in 2000. By contrast, the LMI-LAC average is 5.1 and Chile and Costa Rica posted scores of 6.7 and 5.5, respectively (Figure 3-6).

Figure 3-6  
*Trade, Percent GDP*



<sup>39</sup> For a detailed description of the CAFTA trade capacity building process, see Eric T. Miller. *Achievements and Challenges of Trade Capacity Building: A Practitioner's Analysis of the CAFTA Process and its Lessons for the Multilateral System*. ITD-INTAL Occasional Paper 32. Inter-American Development Bank, October 2005. [http://www.iadb.org/intal/aplicaciones/uploads/publicaciones/i\\_INTALITD\\_OP\\_32\\_2005\\_Miller.pdf](http://www.iadb.org/intal/aplicaciones/uploads/publicaciones/i_INTALITD_OP_32_2005_Miller.pdf).

<sup>40</sup> CAFTA-DR entered into force for El Salvador on March 1, 2006 and in Nicaragua and Honduras on April 1, 2006. Costa Rica has yet to ratify the agreement and legislative and regulatory work is continuing with Guatemala and Dominican Republic to permit its entry into force in the near future.

In assessing Guatemala's export growth, goods and services recovered substantially in 2004 with growth of 12.4 percent after negative growth in 2001 and 2002 (-4.0 percent and -6.8 percent respectively). The contraction in 2001 and 2002 can be attributed to a variety of factors, including the steep decline in the value of coffee exports (see footnote 24) and a cyclical contraction in the United States economy, Guatemala's largest export market.

In terms of the composition of its trade, 25.8 percent of Guatemala's exports and 15.4 percent of its imports in 2003 were services. According to IMF International Financial Statistics, Guatemala's exports and imports of services have grown steadily since 2000. That year, Guatemala is estimated to have exported \$777 million and imported \$825.4 million in services. By 2002, Guatemala's services exports had risen to an estimated \$1.15 billion, while its imports had risen to \$1.07 billion. In 2004, the last year for which we have data, Guatemala exported an estimated \$1.18 billion and imported \$1.29 billion.<sup>41</sup> This trend is consistent with the output data discussed in the Economic Structure section, which shows an increasing share of value added by the services sector. In short, increased output of value-added products is leading to more exports. Disaggregated data on the distribution by services subsectors were not available for this study.

Guatemala's merchandise exports to the world are dominated by food products and manufactured goods (Figures 3-7 and 3-8). In 2004, food products, led by coffee, bananas, and sugar, accounted for 45.2 percent of the total. Food products were followed by manufactured goods (41.8 percent), fuel (8.3 percent), agricultural raw materials (4.2 percent), and ores and metals (0.5 percent). Two-thirds of Costa Rica's exports are in manufactured products and less than one-third is in food products, and in Chile, 53.5 percent of exports are in ores and metals (especially copper) while 21.3 percent are in food products. One key difference between the Chilean and Guatemala food sectors is that Chile exports higher-value products (such as wine, grapes, apples, and asparagus) that command a premium either for the level of processing or for being off-season supplies to northern markets. In the five-year period for which we have data, Guatemala reduced its dependence on food products (56.2 percent in 2000) and increased its percentage of manufactured products (32.0 percent in 2000). Although there seems to be a trend away from food and toward manufactures, a closer look at the data on the production of apparel products, may reveal that the process of transformation may be in jeopardy.

Guatemala's largest single source of manufacturing exports is the apparel sector, most of which consists of cutting and sewing clothing and related products for sale in the U.S. market. In 2005, apparel exports accounted for some 58 percent of total Guatemalan exports to the United States.<sup>42</sup> The IMF estimates that textiles and apparel account for 6.1 percent of Guatemala's current account receipts and 2.6 percent of total employment.<sup>43</sup> Yet after years of steady growth, Guatemala's apparel exports actually declined in 2005. The highly distortionary global system of textile and apparel quotas known as the Multi-Fiber Agreement (MFA) was eliminated at the beginning of 2005, and free trade was permitted in these products. MFA elimination placed

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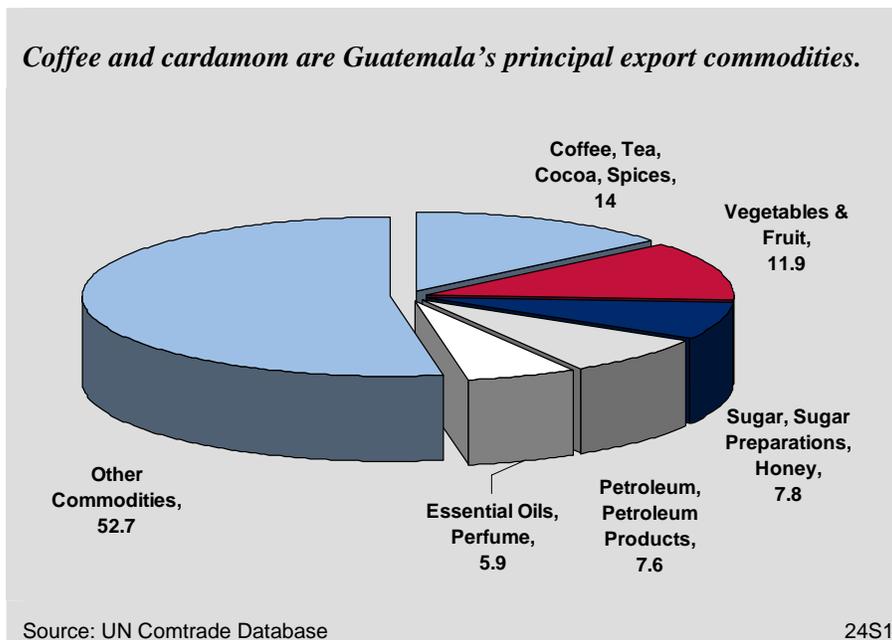
<sup>41</sup> *International Financial Statistics*. International Monetary Fund, January 2006.

<sup>42</sup> The results for Guatemala are available at *TradeStats Express*. International Trade Administration. U.S. Department of Commerce. <http://tse.export.gov>.

<sup>43</sup> *Guatemala: Staff Report for the 2005 Article IV Consultation*. IMF Country Report No. 05/362, International Monetary Fund, October 2005, p.19.

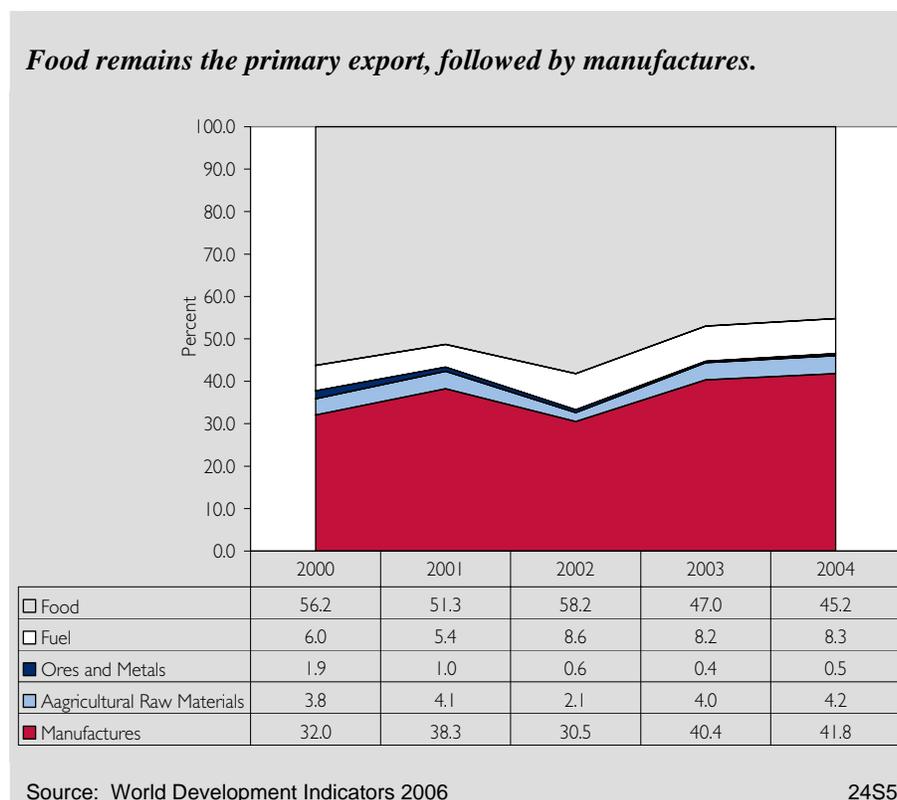
Guatemala and other Central America producers in direct competition with Asian producers; the results are apparent in the data. In 2005, exports in Guatemala's two major categories of apparel declined. Exports of knit or crochet apparel and accessories (HS Chapter 61) amounted to \$1.22 billion in 2005, down from \$1.26 billion in 2004. Similarly, exports of other apparel articles and accessories (HS Chapter 62) amounted to \$601 million, down from \$686 million in 2004. Anecdotal evidence suggests that the trends for 2006 are continuing in the same direction.<sup>44</sup> Policymakers and sector leaders in both the United States and Central America view CAFTA-DR as the centerpiece of their strategy for ensuring the long-term competitiveness of the apparel sector in the region. For this strategy to work to maximum effect, though, trade rules need to be matched with both appropriate firm-level investments and donor support, especially technical assistance in disseminating knowledge of market trends and enhancing specific products and processes.

Figure 3-7  
Concentration of Commodity Exports, Percent



<sup>44</sup> See *TradeStats Express*.

Figure 3-8  
*Structure of Merchandise Exports 2000–2004*



The geographical distribution of Guatemala's merchandise trade underscores the importance of the apparel challenge. Guatemala sends 29.9 percent of its exports to and receives 43.8 percent of its imports from the United States. Guatemala's next-largest market is other Central American Common Market countries, to which it dispatches 41.3 percent of its exports and from which it takes in 12.3 percent of its imports, including 19.0 percent of total exports to and 12.3 percent of imports from El Salvador. Guatemala's next-biggest export market in Central America is Honduras, which imports 10.7 percent of Guatemala's exports. Guatemala's second-biggest import supplier in Central America is Costa Rica, with 4.5 percent.<sup>45</sup> Other important trading partners for Guatemala are the European Union and Mexico (Figures 3-9 and 3-10).

<sup>45</sup> *Guatemala: Statistical Annex*. IMF Country Report No. 05/361, Table 34.

Figure 3-9  
Exports to CAFTA Countries (Current US\$ million)

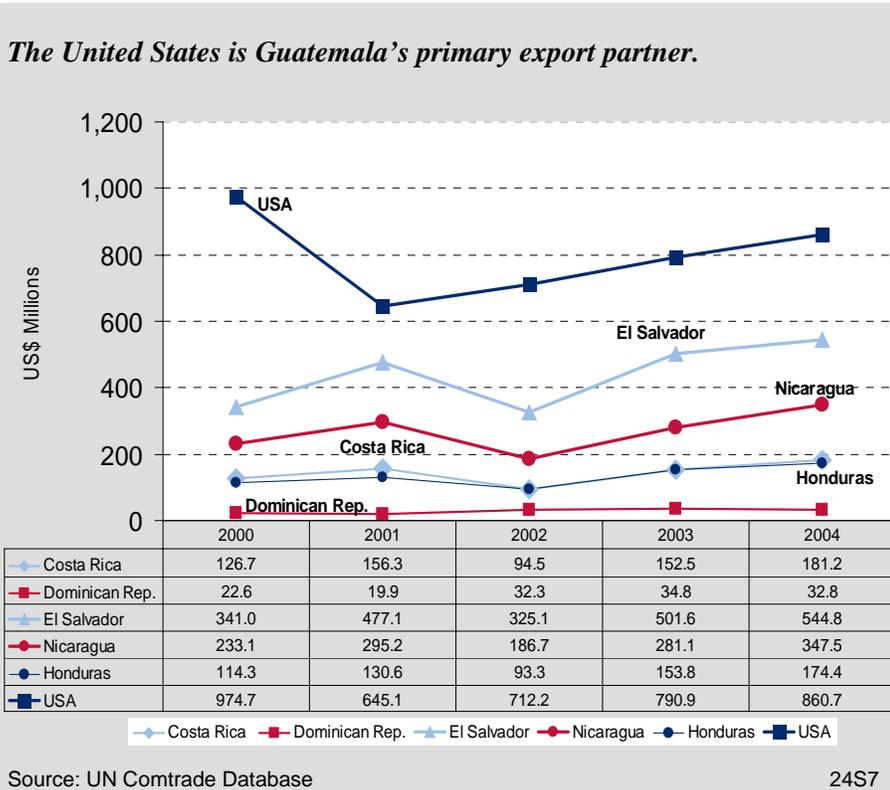
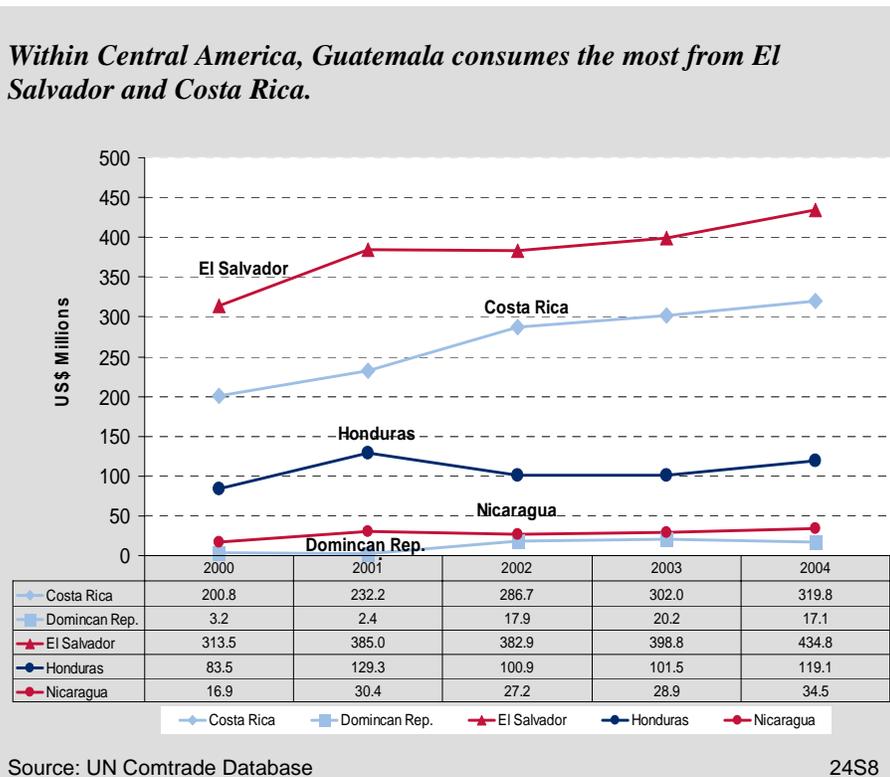


Figure 3-10  
Merchandise Imports from CAFTA Countries Excluding USA (Current US\$ million)



An assessment of the evolution of merchandise trade between Guatemala and its CAFTA-DR partners over the past five years shows a pattern of increasing trade flows but a persistent trade deficit. In 2004, Guatemala sent \$2.14 billion in exports to its CAFTA-DR partners while importing \$4.12 billion from these countries. By contrast, in 2000 Guatemala exported \$1.81 billion to CAFTA-DR countries and imported \$3.37 billion worth of goods. During the 2000–2004 period imports rose steadily while exports ebbed and flowed, hitting a low point of \$1.44 billion in 2002.

In disaggregating the data by country, significant patterns emerge. First, the United States accounts for over 75 percent of Guatemala’s imports from CAFTA-DR countries. Second, while the United States is the largest export market for Guatemala among CAFTA-DR countries, the Salvadoran and Honduran markets are by no means insignificant. Third, Guatemala is running a trade surplus with all CAFTA-DR countries except the United States and Costa Rica, arguably the two most technologically sophisticated countries in the grouping.

After rising to \$975 million in 2000, Guatemala’s exports to the United States dipped and have yet to fully recover, reaching \$861 million in 2004; its imports from the United States have risen from \$1.94 billion in 2000 to \$3.12 billion in 2004. With respect to trade with Costa Rica, Guatemala has run a persistent deficit each year: in 2004 Guatemala sent \$181.2 million in exports to Costa Rica while receiving \$319.8 million in imports. Guatemala’s most significant trade surpluses are with Honduras and Nicaragua, the two CAFTA-DR countries with the least-developed production capacities. In 2004, Guatemala exported to \$347.5 million in goods to Honduras and \$174.4 million to Nicaragua, while importing \$119.1 million and \$34.5 million respectively. Guatemala has a relatively small trading relationship with the Dominican Republic, exporting only \$32.8 million and importing only \$17.1 million in 2004. Finally, El Salvador is Guatemala’s second-most-important trading partner among CAFTA-DR countries.

Although the balance of trade between Guatemala and its other partners has remained steady—whether consistent surpluses or consistent deficits—the Guatemala–El Salvador relationship has ebbed and flowed. In 2000, Guatemala exported \$341.4 million worth of goods to El Salvador and took in \$313.5 million. In 2002, Guatemala sent only \$325.1 million in exports to El Salvador and imported \$382.9 million. By 2004, Guatemala’s trade balance with El Salvador had moved back into positive territory, with Guatemala exporting \$544.8 million to its southern neighbor while importing \$434.8 million from it.

The indicators that measure Guatemala’s trade policy show a reasonably good picture. In the Heritage Foundation trade policy index, which ranges between 1 (excellent) and 5 (poor), Guatemala comes out average, receiving a 3. Costa Rica also scored a 3, while free market trailblazer Chile received top marks, a 1. Guatemala, however, performs relatively well in terms of the average time required to complete import and export processes—an average of 28.0 days. By contrast, the LMI-LAC average time to import or export is 34.7 days and the average for Costa Rica is 39.0 days.

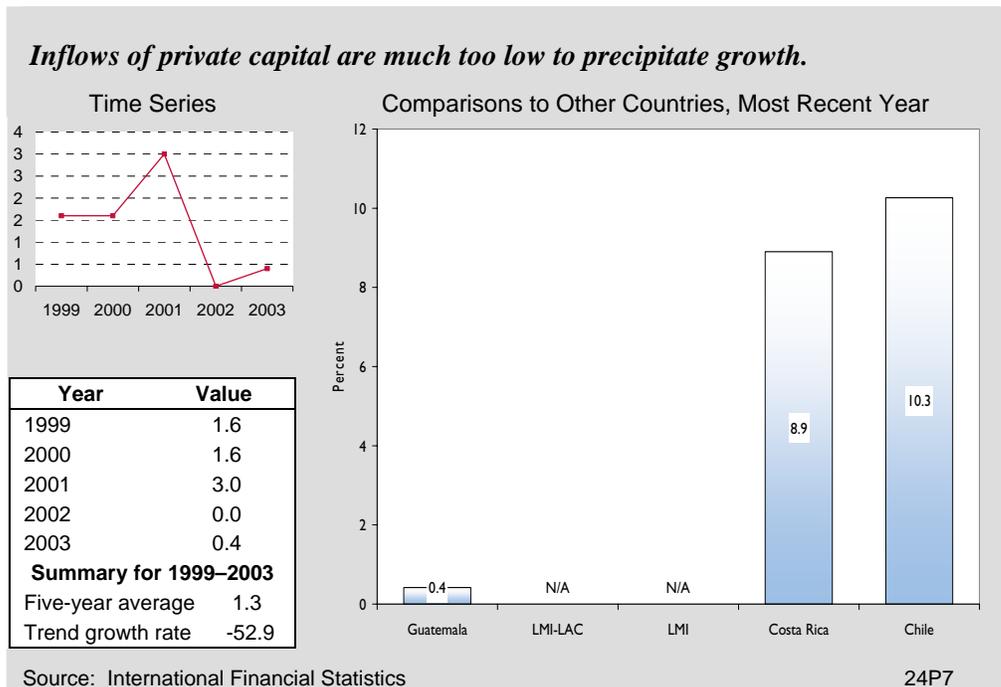
Guatemala’s trade indicators show that further work is required to fully realize the tremendous opportunities provided by CAFTA-DR. Activities that will help Guatemala take advantage of CAFTA-DR that donors may wish to consider financing are (1) a comprehensive trade facilitation audit (perhaps using the WTO trade facilitation questionnaire as a basis) to assess the efficiencies

and bottlenecks in Guatemala's trade system; (2) the aforementioned technical assistance to the apparel sector; (3) assistance to Guatemala in implementing and administering key aspects of the agreement, including rules of origin, intellectual property rights, and aspects of trade in services; (4) development of a strategy to enhance the value-added share of Guatemala's food and agricultural exports; and (5) comprehensive customs reform.<sup>46</sup>

## Foreign Investment

Guatemala's performance in attracting foreign direct investment leaves room for improvement. In 2004, Guatemala's ratio of foreign direct investment as a percentage of GDP was only 0.6 percent, down from 1.2 percent in 2000.<sup>47</sup> This result is well below the statistically predicted benchmark of 3.3 percent and the LMI-LAC average of 2.2. Chile and Costa Rica posted significantly better results of 8.1 percent and 3.4 percent respectively. When analyzing private capital inflows as a percent of GDP, the same holds true. In 2003, Guatemala's result in this category was 0.4 percent. By contrast, Chile and Costa Rica posted results of 10.3 percent and 8.9 percent, respectively. Guatemala's difficulties in attracting foreign direct investment are borne out in the results of the Inward FDI index, which ranges from 0 (poor) to 1 (excellent). Guatemala posted a 0.14, a result which held pretty much steady during the 1998–2002 period. Chile and Costa Rica achieved results of 0.24 and 0.18 respectively (Figure 3-11).

Figure 3-11  
Gross Private Capital Inflows, percent GDP



<sup>46</sup> The importance of comprehensive customs reform is identified in *Trade and Commercial Law Assessment – Guatemala*. USAID, January 2005, p. X-7-9. [http://www.bizlawreform.com/country\\_assess/GuatemalaTCLA.pdf](http://www.bizlawreform.com/country_assess/GuatemalaTCLA.pdf).

<sup>47</sup> During the presidency of Alfonso Portillo (2000–2004), the government took a “confrontational attitude ... towards the private sector (which) ... discouraged many enterprise activities.” This presumably included the attraction of foreign direct investment. *Guatemala Country Economic Memorandum*, World Bank, p. ix.

The entry into force of CAFTA-DR, with its top-of-the-line set of rules governing foreign investment is likely to inspire foreign investors' confidence in Guatemala. The provisions in the agreement for foreign investment define a procedure for resolving disputes between foreign investors and CAFTA-DR governments. The effect of this independent international process is to neutralize the negative effects of weak domestic legal systems by ensuring a fair hearing in the event of a dispute with a host government.

In the years ahead, increasing FDI inflows should be a top policy priority for Guatemala to facilitate long-term growth. It will be difficult, however, for Guatemala to achieve this objective without working to improve its investment climate. Donors may wish to consider (1) providing assistance in undertaking an investment climate review to develop an action agenda designed to strengthen the country's attractiveness to foreign investors; (2) training government officials and the private sector on foreign investment rules in CAFTA-DR; and (3) training officials on the law and practice of the various dispute-settlement mechanisms in the CAFTA-DR agreement, including the investor-state process.

## Current Account

Guatemala's current account deficit averaged 5.0 percent of GDP in the period 2000–2004. After soaring to 6.0 percent of GDP in 2001, the deficit fell to 4.3 percent by 2004. The IMF attributes the narrowing of the current account deficit in no small measure to a sharp increase in worker remittances, which now amounts to more than 9 percent of GDP<sup>48</sup> or the equivalent of 56.2 percent of exports. Guatemalan workers residing abroad sent home \$2.68 billion in 2004, up from \$584 million in 2001.<sup>49</sup> While positive for Guatemala in the short run, increased remittances have already forced the Bank of Guatemala to intervene to prevent inflation and a significant appreciation of the quetzal.<sup>50</sup> In the medium term, the persistent growth of remittance income risks encouraging policymakers to be less proactive than necessary in addressing Guatemala's structural problems, thereby making the country especially vulnerable to a downturn in the U.S. economy, the source of most of Guatemala's remittances. Donors should consider providing assistance to Guatemala in designing and implementing strategies for translating remittances into productive investments (and therefore development), rather than using them solely as financing for consumption. In designing such a program, donors may wish to review the experience and methodologies applied by Salvadoran communities in the United States and El Salvador.

## International Financing

At 23.2 percent, Guatemala has one of the lowest public debt-to-GDP ratios in Latin America.<sup>51</sup> Another instrument, the present value of debt as a percentage of gross national income, tells the same story. Guatemala posted a level of 23.0 percent in 2004, down from a high of 25.0 percent

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<sup>48</sup> *Guatemala: Staff Report for the 2005 Article IV Consultation*. IMF Country Report No. 05/362, p.8.

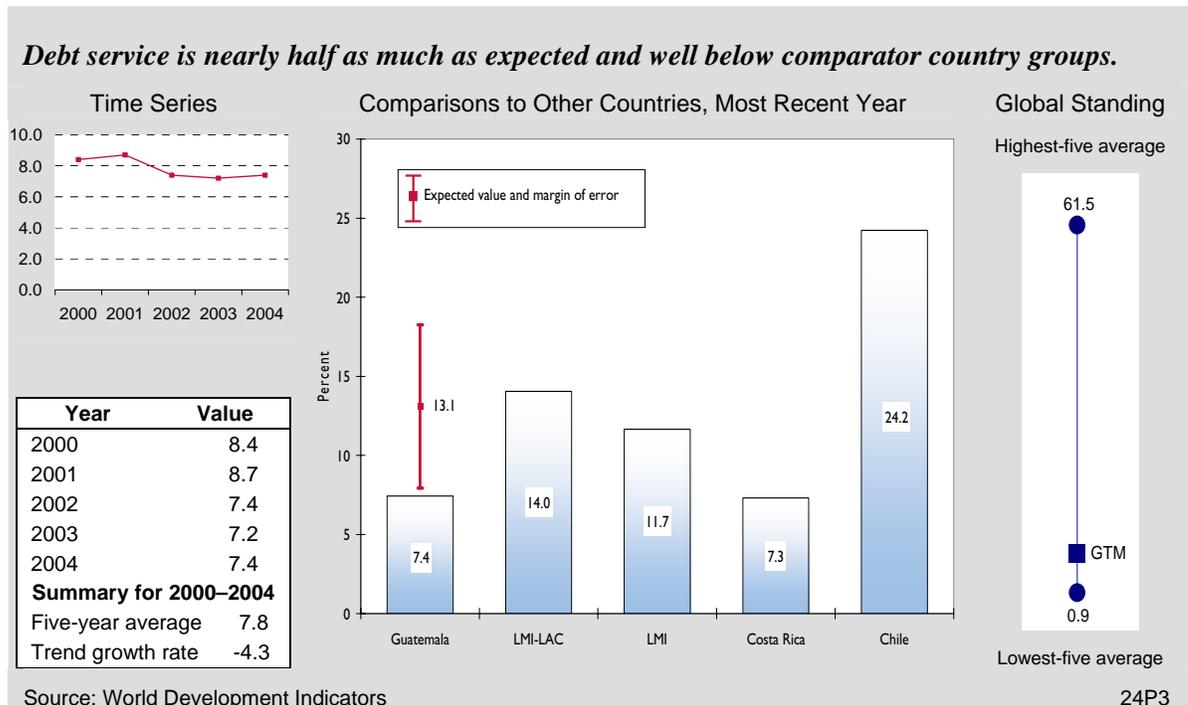
<sup>49</sup> See Donald F. Terry and Steven R. Wilson (eds.). *Beyond Small Change: Making Migrant Remittances Count*. Washington, DC: Inter-American Development Bank, 2005. For 2001–2003 data, see p. 197. For 2004 data, see p.4 (Map 1.1).

<sup>50</sup> *IDB Country Strategy with Guatemala*, p.5.

<sup>51</sup> *Ibid.* These are 2003 data. The IDB Country Strategy notes that this figure is up from 19.5 percent in 1996, in large part because of the need to sterilize the effect of remittances.

in 2001. By comparison, the regression benchmark for Guatemala was 47.3 percent. In 2004, the present value of debt in Chile was 56.7 percent while in Costa Rica it was 35.5 percent. Low debt levels mean low debt service payments. In 2004, Guatemala's debt service ratio as measured by percentage of exports totaled 7.4 percent. Thus, Guatemala's debt service ratio is less than the Chile's level (24.2 percent), half the LMI-LAC average (14.0 percent), and on par with Costa Rica's level (7.3 percent) (Figure 3-12).

Figure 3-12  
*Debt Service Ratio, Percent of Exports*



Guatemala has a healthy situation with respect to international reserves, which covered 4.6 months of imports in 2005. This level of reserved provides more stability than the 2.8 months that Guatemala had in 1999. Guatemala's current virtuous situation exceeds both the benchmark (4.2 months) and the LMI-LAC average (4.0 months). International aid flows are equal to 0.8 percent of Guatemala's GNI, near the LMI-LAC average of 1.0. The aid-to-GNI ratio is negligible for Chile and Costa Rica because neither country is eligible for nonreimbursable assistance because of their higher per capita incomes.

## ECONOMIC INFRASTRUCTURE

A country's physical infrastructure—for transportation, communications, energy, and information technology—is vital for expanding trade, productive capacity, and competitiveness. Guatemala's rugged geographic setting, including mountains and thick tropical forest, make a nationwide infrastructure initiative more costly and complicated, all other things being equal, than a similar project in a temperate country with a gentle landscape. Regardless, Guatemala scores from average to poor in key infrastructure areas.

The broadest measure of the overall quality of a country's infrastructure is a perception index prepared by the World Economic Forum. Guatemala scored a 2.8 out of a possible 7, equal to the LMI-LAC average and slightly below Costa Rica (2.9). Chile scored a 4.8. When this index is disaggregated by type of infrastructure, Guatemala's strengths and weaknesses become readily apparent. Guatemalan infrastructure quality ranks the highest in air transport and electricity, both at 3.7. These are followed by ports at 2.6 and railroads at 1.4. These ratings are nearly identical to the scores for the LMI-LAC average but are well below those of Chile, whose infrastructure is of a much higher quality.

A major infrastructure priority for Guatemala is to attract investment, either private or donor-financed, to upgrade the country's ports. Ports are central to any country's international competitiveness and to Guatemala's ability to take advantage of CAFTA-DR. In Guatemala, Puerto Barrios, operated under a private concession, moves each metric ton of cargo four times more efficiently than Puerto Quetzal and eight times more efficiently than Puerto Santo Thomas, both of which are publicly owned.<sup>52</sup> Railroads, despite ranking lower, are less of an infrastructure priority given the cost and complications of building and maintaining an efficient rail network in Guatemala's geographic setting.

Another high infrastructure priority should be rural electrification. Although the quality of Guatemala's electricity infrastructure in the aggregate is not especially bad, availability in rural and urban areas and for indigenous and nonindigenous Guatemalans varies widely. The World Bank reports that although 97 percent of urbanized, nonindigenous people and 89 percent of urbanized indigenous people have access to electricity in Guatemala, only 61.5 percent of nonindigenous people and 50 percent of indigenous people in rural areas have access to electricity (Figure 3-13).<sup>53</sup>

On the telecommunications front, Guatemala's performance appears mixed, though some data are dated. The average cost of local phone calls has fallen steadily in recent years (\$0.08 in 2001), and the density of telephone service increased two-and-a-half times between 2000 and 2004 (from 137 per 1,000 to 350 per 1,000). The telephone density increase is probably due to the explosion in the number of cell phones in Guatemala—from 30,000 in 1995 to 1.14 million in 2002.<sup>54</sup> By contrast, as of 2004, only 62 Guatemalans per 1,000 used the Internet, compared with 267 in Chile and 235 in Costa Rica. These data indicate that despite progress, Guatemala has a long way to go in having competitive ICT infrastructure. If Guatemala hopes to attract foreign investment in manufacturing and services, it must invest in bringing its ICT system to at least the standards of its key competitors such as Costa Rica and El Salvador.

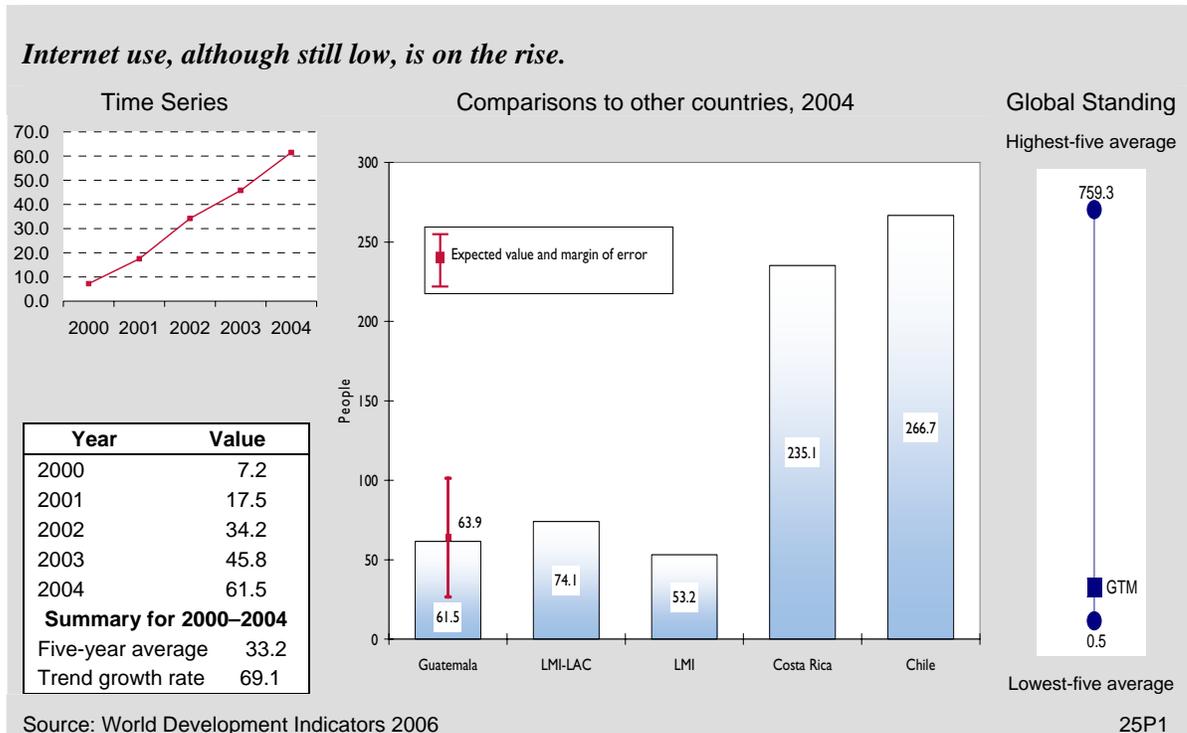
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<sup>52</sup> *IDB Country Strategy with Guatemala*, p.6.

<sup>53</sup> See Hall and Patrinos. *Indigenous Peoples, Poverty and Human Development in Latin America: 1994-2004*. World Bank. May 2005.

<sup>54</sup> *Guatemala Country Economic Memorandum*, World Bank, p. xi.

Figure 3-13  
*Internet Users per 1,000 People*



## SCIENCE AND TECHNOLOGY

Science and technology are central to dynamic growth, because technical knowledge is a driving force for rising productivity and competitiveness. Even for lower-middle-income countries such as Guatemala, transformational development increasingly depends on acquiring and adapting technology from the global economy and applying it in ways that are appropriate to their level of development. A lack of capacity to access and use technology prevents an economy from leveraging the benefits of globalization. In the FDI Technology Transfer index, which is on a scale of 1 (little new technology) to 7 (lots of new technology), Guatemala registered a 4.4 in 2002, indicating that FDI in Guatemala brings an average amount of new technology into the economy, in concordance with the LMI LAC average of 4.6, the statistical benchmark of 4.4, and the LMI average of 4.5. Chile and Costa Rica's scores—5.3 and 5.5 respectively—indicate that there is room for improvement in technology transfer.

Perhaps a more important indicator in assessing the state of science and technology in Guatemala is the fact that zero patent applications were filed by residents in 2002, the last year of data available. Although Guatemalan citizens filed applications in previous years, the irregularity of the figures points to a lack of an organized innovation system in the country. Corroborating this hypothesis, the World Bank reports<sup>55</sup> that Guatemala suffers from poor technological performance as a result of its weak capacity to absorb and diffuse internationally available technology, let alone innovate domestically. Technological capacity is strongly linked to

<sup>55</sup> Ibid.

educational levels and the productive capacity of the citizenry—areas still in need of improvement in Guatemala.



# 4. Pro-Poor Growth Environment

Rapid growth is the most powerful and dependable instrument for poverty reduction, yet the link from growth to poverty reduction is not mechanical. In some cases, income growth for poor households exceeds the overall rise in per capita income, while in other conditions growth benefits the non-poor far more than the poor. A pro-poor growth environment stems from policies and institutions that improve opportunities and capabilities for the poor while reducing their vulnerability. Pro-poor growth is associated with improvements in primary health and education; the creation of jobs and income opportunities; the development of skills, microfinance, and agriculture; and gender equality.<sup>56</sup> This section focuses on four of these issues: health; education; employment and the workforce; and agricultural development.

## HEALTH

The provision of basic health service is a major form of human capital investment and a significant determinant of growth and poverty reduction. Although health programs do not fall under EGAT, an understanding of health conditions can influence the design of economic growth interventions.

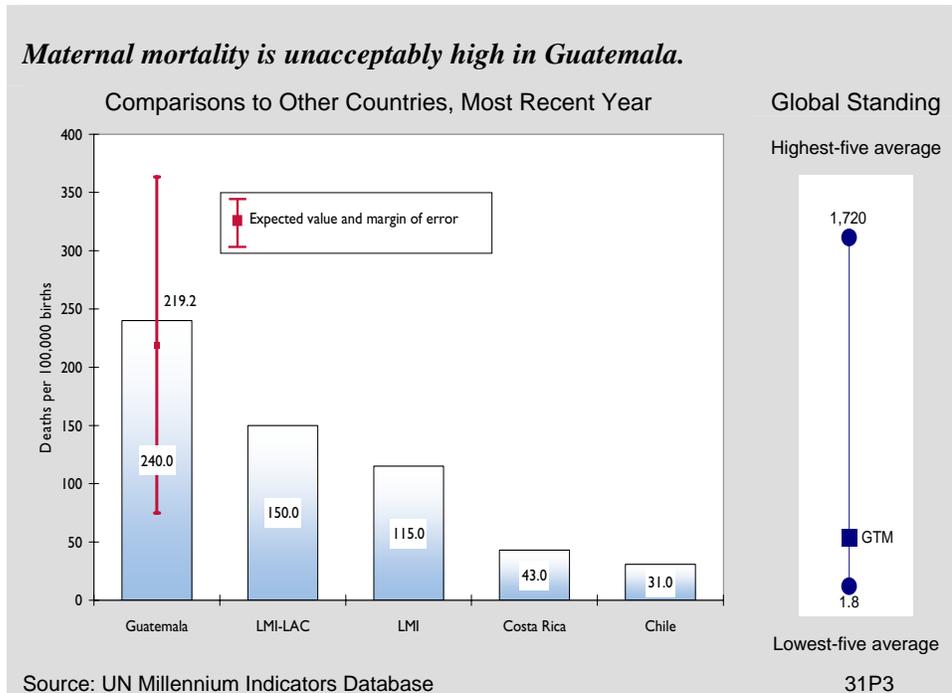
The poverty problem in Guatemala is underscored by very poor indicators for public health. Maternal mortality is very high, at 240 deaths per 100,000 live births. The LMI-LAC average for maternal mortality is 150, while the figures for Costa Rica and Chile are 43.0 and 31.0 respectively. High maternal mortality is linked to poor provision of public healthcare. In 2002 only 41 percent of births in Guatemala were attended by health care personnel, whereas in 2001 in Chile and Costa Rica, almost all births were attended by a health care worker (100 percent and 98 percent respectively). Despite Chile and Costa Rica's exemplary performance on this indicator the LMI-LAC average is 80 percent, nearly twice the Guatemala's rate (Figure 4-1).

Guatemala does slightly better on other indicators but still performs poorly. Life expectancy at birth in 2005 was 67.9 years. This is slightly lower than the regression estimate of 68.4 years and the LMI-LAC average of 70.2 years, but about 10 years less than in Chile (78.0 years) or Costa Rica (78.7 years). Guatemala has a higher-than-average HIV rate for the region (although not high in absolute terms). The HIV prevalence rate was 1.1 percent of the population in 2003, while the regional average is 0.7, near Costa Rica's rate of 0.6 percent and Chile's rate of 0.3 percent.

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<sup>56</sup> Since this report focuses on economic growth performance, this report does not cover emergency relief.

Figure 4-1  
*Maternal Mortality Rate*

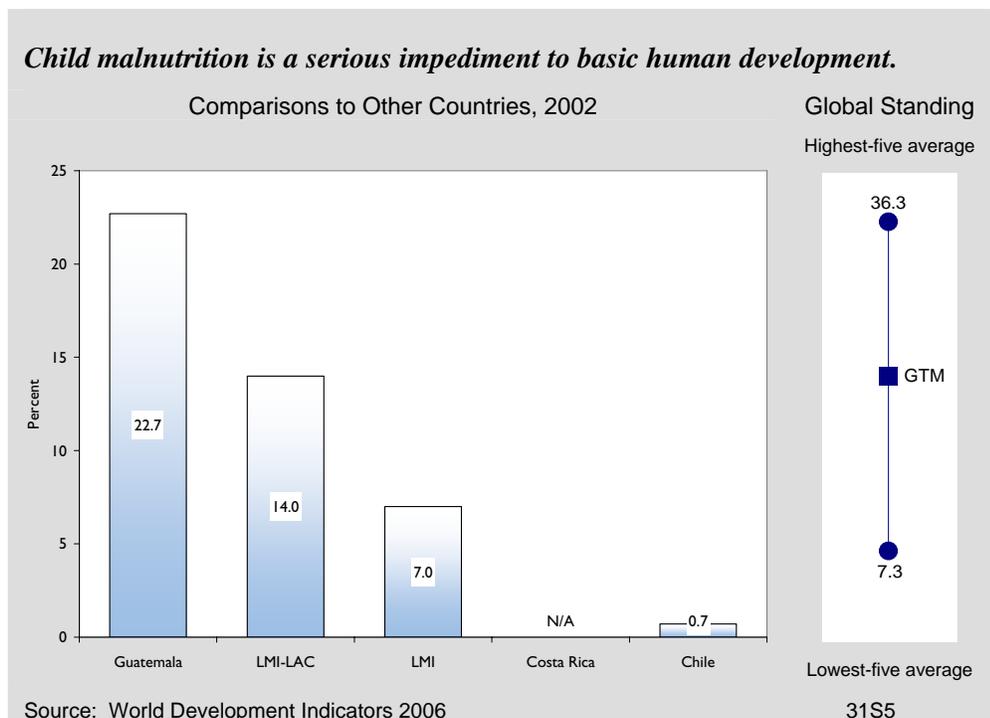


Guatemala's health care woes extend to the youngest and most vulnerable in society. The prevalence of child malnutrition was high in 2002 at 22.7 percent. Although child malnutrition is a common problem in the region, Guatemala's rate is higher than the 14 percent average for LMI-LAC and much higher than the 0.7 percent of Chilean children who suffer from malnutrition. Malnourished children do not have the capacity to learn; by hindering education development malnutrition becomes a detriment to human capital development. The child immunization rate is also low, 79.5 percent, compared to the LMI-LAC average of 87.3 percent. The provision of good health care and nutrition to infants and children is fundamental if they are to grow into productive adults (Figure 4-2).

Guatemala suffers from a lack of access to improved sanitation—only 61.0 percent of the population have access to improved sanitation—especially compared with the 71.0 percent LMI-LAC average and Costa Rica's and Chile's 92.0 percent. Access to an improved water source is good, however, with 95 percent of the population having access to good potable water. This exceeds the LMI-LAC average at 89.5 percent and meets the standard set by Chile (95.0 percent) and Costa Rica (97.0 percent).

The poor public health results can be explained by a multitude of factors ranging from geography to poverty to social exclusion. Besides these factors, public health is underfunded in Guatemala, with only 2.1 percent of GDP going to public health expenditure in 2003, compared to the LMI-LAC average of 3.5 percent. Increasing expenditure on public health could drastically improve public health and the formation of human capital. This, in turn, is essential to Guatemala's ability to compete in knowledge-based sectors in the long term.

Figure 4-2  
Prevalence of Child Malnutrition



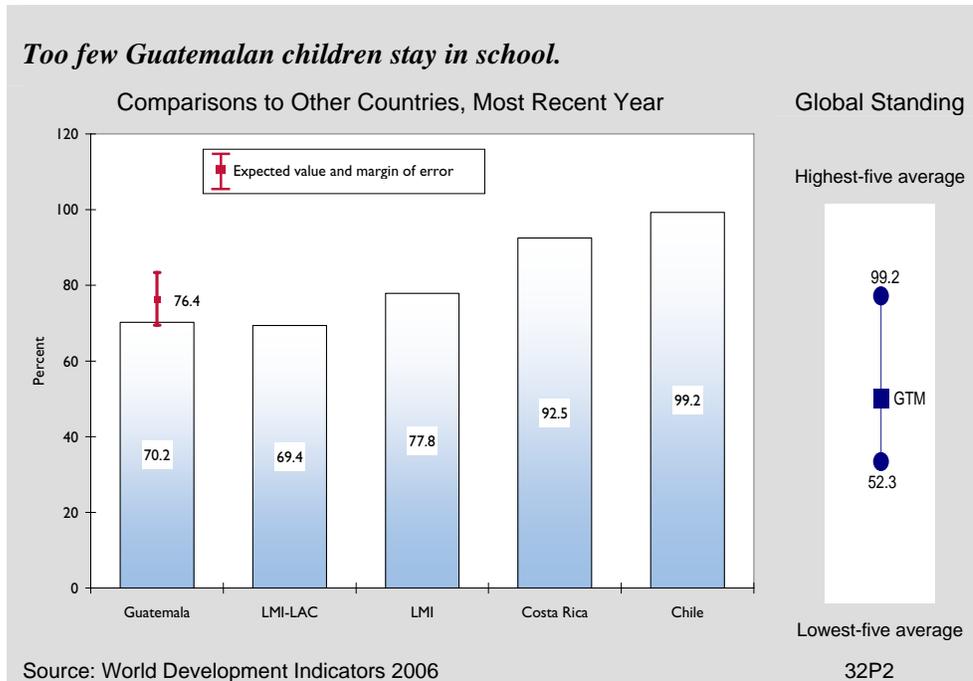
## EDUCATION

Although significant gender, ethnic, and poverty disparities still exist, access to basic education in Guatemala is improving. Net primary enrollment in 2004 was 93.0 percent, up from 85.8 percent in 2000. Classrooms are crowded, however, with an average pupil–teacher ratio of 30.9 in 2004. Although this ratio is lower than the ratio in Chile (34.1), it is much higher than the LMI-LAC average of 23.7 and the Costa Rican average of 22.4.

Student retention has improved dramatically in Guatemala’s educational system in the past five years, from 57.9 percent remaining in school through grade five in 2000 to 70.2 percent in 2004. Yet much remains to be done when the statistical benchmark of 76.4 percent and Costa Rica’s and Chile’s 92.5 percent and 99.2 percent, respectively, are taken into account. Indigenous peoples are at a disadvantage in receiving basic education: the average indigenous Guatemalan age 15 to 31 has half as much education as a nonindigenous Guatemalan (3.5 years compared to 6.3 years).<sup>57</sup> Gender differences in educational attainment are also pronounced—the net primary enrollment rate for females was 90.6 percent in 2004 and 95.4 percent for males, indicating that fewer women than men have any formal education. In addition, retention for males, at 79.4 percent, is better than for females, at 76.4 percent (Figure 4-3).

<sup>57</sup>See Hall and Patrinos. *Indigenous Peoples, Poverty and Human Development in Latin America: 1994-2004*. World Bank. May 2005.

Figure 4-3  
Persistence in School to Grade 5, Total



Low primary enrollment and persistence rates have translated into a youth literacy rate of 82.2 percent in 2004, compared with a statistically predicted benchmark of 88.2 percent, an LMI-LAC average of 94.5 percent, and approximately 98 percent for Costa Rica and Chile. The World Bank reports that female illiteracy in Guatemala (39 percent)—already high—is more pronounced among indigenous women (62 percent) and the poor (46 percent).<sup>58</sup> Guatemala's meager educational attainment may be due in part to exceptionally low public expenditures on education. Expenditure per student as a percent of GDP per capita was 4.7 percent for primary education and 3.7 percent for secondary education. The LMI-LAC average for primary and secondary is nearly triple that, at 12.7 percent and 11 percent respectively. Funding basic education needs to become a top priority if Guatemala is to build a competitive workforce.

## EMPLOYMENT AND WORKFORCE

Formal participation in Guatemala's labor force is low at 69.1 percent of the population in 2003. This low rate is largely attributable to very low levels of female labor force participation, 43.2 percent, compared to the male labor force participation rate of 94.9 percent. It is likely that the low labor force participation numbers for women reflect the fact that they tend to be active in the large informal sector in rural areas. In 2000, an estimated 65 percent of the labor force participated in the informal sector. This trend is more pronounced in rural areas, where 75 percent of workers labor informally.<sup>59</sup> The existence of a large informal sector poses several fundamental problems. First, individuals working in the informal sector are much more vulnerable to poor or

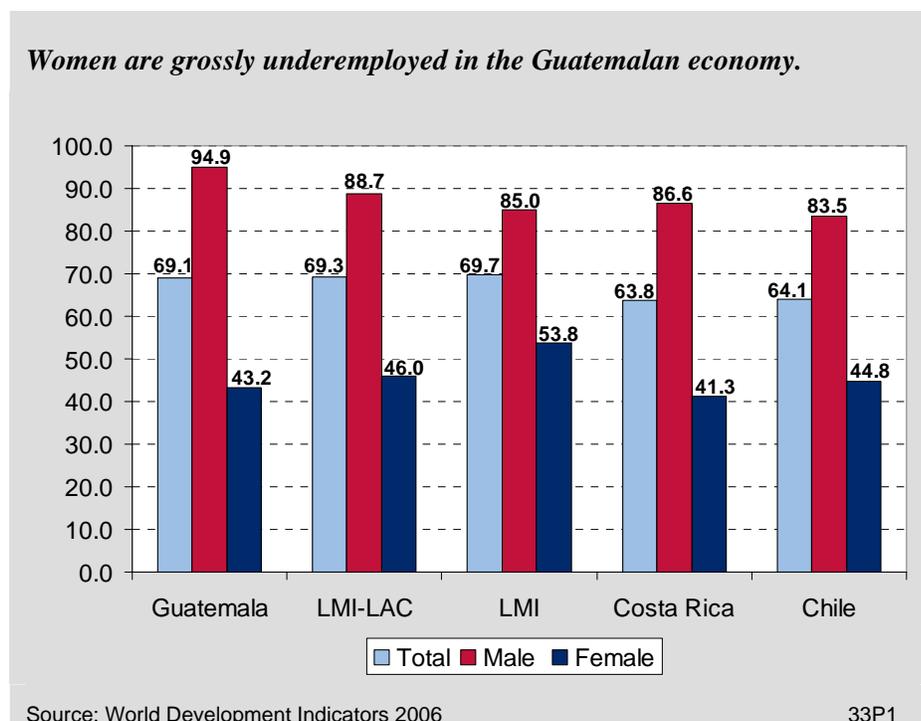
<sup>58</sup> *Poverty In Guatemala* World Bank Report No. 24221-GU, p.63.

<sup>59</sup> *Guatemala Country Economic Memorandum*, World Bank, p.46.

abusive labor practices and are without legal recourse. Second, a small formal sector translates into a small tax base for the government and therefore low revenues (Figure 4-4).

Figure 4-4

*Total, Male, and Female Labor Force Participation Rates for Guatemala and Other Countries, Most Recent Year*



Guatemala's rigidity-of-employment index score of 40 is typical of LMI-LAC countries (44.0), Costa Rica (39.0), and the regression benchmark (42.8).<sup>60</sup> However the score is still high, and rigidity in employment may contribute to a large informal sector.

The labor force in Guatemala is growing at a rate of 2.6 percent a year, on par with the regression benchmark. In recent years, a significant number of Guatemalans have migrated abroad seeking jobs and opportunities—hence the spike in remittances mentioned earlier.

The employment and workforce figures strongly suggest an urgent need for job creation in the formal sector. This, in turn, reinforces the importance of preparing Guatemala to take advantage of the trade and investment opportunities that can be generated by CAFTA-DR.

## AGRICULTURE

Guatemala could benefit from improved efficiency in the agricultural sector. Although agricultural value added per worker (\$2,285) is slightly higher than the LMI-LAC figure (\$2,102) and exceeds the statistical benchmark (\$1,760.5), these figures account for farmers in the formal sector but not the rural subsistence economy. The cereal yield, which is an indicator of production

<sup>60</sup> The index scores from 0 (for minimum rigidity) to 100 (for extreme rigidity).

of crops for basic sustenance, is low at 1,760 kilograms per hectare, while the LMI-LAC average is 2,413 kilograms and Costa Rica and Chile have yields of 3,803 kilograms and 5,813 kilograms per hectare respectively. On the agricultural policy cost index Guatemala ranks in the middle, with a score of 3.5, indicating neither excessively restrictive nor liberal policies for agriculture. Because malnutrition has been a persistent problem in Guatemala, the country's present challenge is to increase agricultural productivity for the undernourished (especially the rural poor) as well as for agricultural export. A program to enhance agricultural efficiency would also require an enhancement of the infrastructure necessary for moving the goods to market, particularly secondary roads. The best, most efficiently produced agricultural product is of little use if it cannot be moved to market in a timely fashion.

# 5. Conclusions: Key Findings

Ten years have passed since Guatemalans signed the peace accords. But Guatemala still faces important challenges to building a more just, equitable, and prosperous society. Guatemala has a number of important strengths but also suffers from a number of notable weaknesses.

Guatemala's strengths include

- ***Commitment to pro-growth policies.*** The Berger Administration has worked diligently to put Guatemala on a pro-growth path. The government has excellent relations with the private sector and has rolled out a comprehensive strategy to address many of Guatemala's competitiveness challenges.
- ***Sound public financial management.*** Guatemala has very good public financial management. The fiscal deficit is very low and interest rates have fallen significantly from the double-digit levels of five years before. Inflation, although not within the 4–6 percent target range, is under control. The Central Bank has also moved to prevent a remittance-driven real appreciation of the currency.
- ***Low public indebtedness.*** Guatemala has one of the lowest levels of public indebtedness in Latin America. This provides the country with the fiscal space to make targeted investments that will strengthen the competitiveness of the country and social conditions in the years ahead.
- ***CAFTA-DR.*** Through CAFTA-DR, Guatemalan producers of goods and services have secure, tariff- and quota-free access to the largest consumer market in the world. Guatemala will also benefit from CAFTA-DR's Class A rules on, inter alia, investment, intellectual property, government procurement, and transparency.
- ***Improvements in education.*** Guatemala's educational system has made significant improvements in the past five years in enrollment and retention. Improvements in the educational participation rate are fundamental to human capital development and to efforts to improve Guatemala's competitiveness in the medium-to-long term.

Guatemala's key weaknesses include

- ***High levels of income inequality.*** Guatemala has the second-worst income distribution of any country in Latin America (after Brazil). A reduction of the disparities between rich and poor in Guatemala is fundamental to the country's long-term social stability and economic development.
- ***High levels of violent crime and low levels of rule of law.*** All levels of society in Guatemala are deeply effected by violent crime—whether as victims or by paying for security to avoid becoming victims. The high social and economic costs of crime coupled with poor ratings for the rule of law and a culture of impunity impede Guatemala's development significantly.

- **Highly marginalized indigenous population.** Indigenous Guatemalans have access to fewer opportunities and have much lower levels of social and economic attainment than their nonindigenous counterparts, which creates myriad complex dynamics. It is difficult for any country to realistically expect to develop if 40 percent of its population is marginalized.
- **Poor performance on key social indicators.** Guatemala scores particularly poorly on health and nutrition indicators. Poor health and nutrition lead to stunted physical and mental development, lower life expectancy, and the deaths of mothers and children at birth.
- **Gender inequality.** Guatemala has significant gender inequality cutting across society in terms of employment, education, and health.
- **Infrastructure.** Guatemala needs to improve its infrastructure to be able to compete with other CAFTA-DR countries successfully. Upgrading the country's ports is a top priority.

Guatemala's donors must choose among many competing priorities. Donors should consider providing assistance in the following areas among their highest priorities:

- Implementing CAFTA-DR and taking advantage of the opportunities generated by CAFTA-DR, including (1) a comprehensive trade facilitation audit; (2) technical assistance to the apparel sector; (3) assistance in implementing and administering rules of origin, intellectual property rights, and aspects of trade in services; (4) development of a strategy to enhance the value added share of Guatemala's food and agricultural exports; and (5) comprehensive customs reform
- Improving the economic and educational opportunities for indigenous Guatemalans by developing delivery mechanisms for social programs to geographically dispersed communities and improving the rural infrastructure that provides indigenous Guatemalans with access to markets
- Encouraging regional cooperation and coordination to fight transnational criminal gangs.
- Improving health and nutrition and continuing the positive trends in education To address these multifaceted issues, including the profound challenges of gender equality and indigenous marginalization, donors in Guatemala must coordinate their activities more closely with each other and work more closely with local communities rather than just the central government.
- Channel remittances to investment activities as well as to consumption. Donors have an important role to play in strengthening the financial management skills of those receiving remittances and the intermediaries that can channel remittances toward productive purposes.

# Appendix

## CRITERIA FOR SELECTING INDICATORS

The economic performance evaluation is designed to balance the need for broad coverage and diagnostic value, on the one hand, and the requirement of brevity and clarity, on the other. The analysis covers 15 economic growth–related topics and just over 100 variables. For the sake of brevity, the write-up in the text highlights issues for which the “dashboard lights” appear to be signaling problems, which suggest possible priorities for USAID intervention. The accompanying table provides a full list of indicators examined for this report. The separate Data Supplement contains the complete data set for Guatemala, including data for the benchmark comparisons, and technical notes for every indicator.

For each topic, the analysis begins with a screening of primary performance indicators. These Level I indicators are selected to answer the question “Is the country performing well or not in this area?” Primary indicators also include descriptive variables such as per capita income, the poverty head count, and the age dependency rate.

When Level I indicators suggest weak performance, the analysis reviews a limited set of diagnostic supporting indicators. These Level II indicators provide additional details or shed light on why the primary indicators may be weak. For example, if economic growth is poor, investment and productivity can serve as diagnostic indicators. If a country performs poorly on educational achievement as measured by the youth literacy rate, expenditure on primary education and the pupil–teacher ratio are determinants.<sup>61</sup>

The indicators have been selected on the basis of the following criteria. Each must be accessible through USAID’s Economic and Social Database or convenient public sources, particularly on the Internet. They should be available for a large number of countries, including most USAID client states, to support the benchmarking analysis. The data should be sufficiently timely to support an assessment of country performance that is suitable for strategic planning purposes. Data quality is another consideration. For example, subjective survey responses are used only when actual measurements are not available. Aside from a few descriptive variables, the indicators must also be useful for diagnostic purposes. Preference is given to measures that are widely used, such as Millennium Development Goal indicators, or evaluation data used by the Millennium Challenge Corporation. Finally, an effort has been made to minimize redundancy. If two indicators provide similar information, preference is given to one that is simplest to understand or most widely used. For example, both the Gini coefficient and the share of income

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<sup>61</sup> Deeper analysis of the topic using more detailed data (level III) is beyond the scope of this series.

accruing to the poorest 20 percent of households can be used to gauge income inequality. We use the income share because it is simpler and more sensitive to change.

## BENCHMARKING METHODOLOGY

Comparative benchmarking is the main tool used to evaluate each indicator. The analysis draws on several criteria rather than a single mechanical rule. The starting point is a comparison of performance in Guatemala relative to the average for countries in the same income group and region—in this case, Latin America and Caribbean countries with lower-middle income.<sup>62</sup> For added perspective, three other comparisons are made: (1) the global average for this income group; (2) respective values for two comparator countries selected by the Guatemala mission (in this case, Chile and Costa Rica); and (3) the average for the five best- and five worst-performing countries globally. Most comparisons are framed in terms of values for the latest year of data from available sources. Five-year trends are also taken into account when this information sheds light on the performance assessment.<sup>63</sup>

For some variables, a second source of benchmark values uses statistical regression analysis to establish an expected value for the indicator, controlling for income and regional effects.<sup>64</sup> This approach has three advantages. First, the benchmark is customized to Guatemala's specific income level. Second, the comparison does not depend on the exact choice of reference group. Third, the methodology allows quantification of the margin of error and establishes a "normal band" for a country with Guatemala's characteristics. An observed value falling outside this band on the side of poor performance signals a serious problem.<sup>65</sup>

Finally, when relevant, Guatemala's performance is compared against absolute standards. For example, if the Corruption Perception index for a given country is below 3.0, this is a sign of serious economic governance problems, regardless of the regional comparisons or regression result.

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<sup>62</sup> Income groups as defined by the World Bank for 2005. For this study, the average is defined in terms of the mean; future studies will use the median instead because the values are not distorted by outliers.

<sup>63</sup> The five-year trends are computed by fitting a log-linear regression line through the data points. The alternative of computing average growth from the end points produces aberrant results when one or both of those points diverges from the underlying trend.

<sup>64</sup> This is a cross-sectional OLS regression using data for all developing countries. For any indicator,  $Y$ , the regression equation takes the form:  $Y$  (or  $\ln Y$ , as relevant) =  $a + b * \ln \text{PCI} + c * \text{Region} + \text{error}$  – where PCI is per capita income in PPP\$, and Region is a set of 0-1 dummy variables indicating the region in which each country is located. Once estimates are obtained for the parameters  $a$ ,  $b$  and  $c$ , the predicted value for Guatemala is computed by plugging in Guatemala-specific values for PCI and Region. Where applicable, the regression also controls for population size and petroleum exports (as a percentage of GDP).

<sup>65</sup> This report uses a margin of error of 0.66 times the standard error of estimate (adjusted for heteroskedasticity, where appropriate). With this value, 25 percent of the observations should fall outside the normal range on the side of poor performance (and 25 percent on the side of good performance). Some regressions produce a very large standard error, giving a "normal band" that is too wide to provide a discerning test of good or bad performance.

## LIST OF INDICATORS

Indicators	Level <sup>a</sup>	MDG, MCA, or EcGov <sup>b</sup>	Indicator Code
<b>OVERVIEW OF THE ECONOMY</b>			
<b>Growth Performance</b>			
Per capita GDP, \$PPP	I		11P1
Per capita GDP, current US\$	I		11P2
Real GDP growth	I		11P3
Growth of labor productivity	II		11S1
Investment Productivity - Incremental Capital- Output Ratio (ICOR)	II		11S2
Gross fixed investment, % GDP	II		11S3
Gross fixed private investment, % GDP	II		11S4
<b>Poverty and Inequality</b>			
Human poverty index	I		12P1
Income-share, poorest 20%	I		12P2
Population living on less than \$1 PPP per day	I	MDG	12P3
Poverty headcount, by national poverty line	I	MDG	12P4
Income-share, richest 20%	I		12P5
Ratio of income shares, richest 20% to poorest 20%	I		12P6
PRSP Status	I	EcGov	12P5
Population below minimum dietary energy consumption	II	MDG	12S1
Poverty gap at \$1 PPP a day	II		12S2
<b>Economic Structure</b>			
Labor force structure	I		13P1
Output structure	I		13P2
<b>Demography and Environment</b>			
Adult literacy rate	I		14P1
Age dependency rate	I		14P2
Environmental sustainable index	I		14P3
Population size and growth	I		14P4
Urbanization rate	I		14P5
<b>Gender</b>			
Adult literacy rate, ratio of male to female	I	MDG	15P1
Gross enrollment rate, all levels, ratio of male to female,	I	MDG	15P2
Life expectancy at birth, ratio of male to female	I		15P3

Indicators	Level <sup>a</sup>	MDG, MCA, or EcGov <sup>b</sup>	Indicator Code
<b>PRIVATE SECTOR ENABLING ENVIRONMENT</b>			
<b>Fiscal and Monetary Policy</b>			
Govt. expenditure, % GDP	I	EcGov	21P1
Govt. revenue, % GDP	I	EcGov	21P2
Growth in the money supply	I	EcGov	21P3
Inflation rate	I	MCA	21P4
Overall govt. budget balance, including grants, % GDP	I	EcGov	21P5
Composition of govt. expenditure	II		21S1
Composition of govt. revenue	II		21S2
Composition of money supply growth	II		21S3
<b>Business Environment</b>			
Corruption perception index	I	EcGov	22P1
Ease of doing business ranking	I	EcGov	22P2
Rule of law index	I	MCA / EcGov	22P3
Cost of starting a business, % GNI per capita	II	MCA / EcGov	22S1
Procedures to enforce contract	II	EcGov	22S2
Procedures to register property	II	EcGov	22S3
Procedures to start a business	II	EcGov	22S4
Time to enforce a contract	II	EcGov	22S5
Time to register property	II	EcGov	22S6
Time to start a business	II	EcGov	22S7
<b>Financial Sector</b>			
Domestic credit to private sector, % GDP	I		23P1
Interest rate spread	I		23P2
Money supply, % GDP	I		23P3
Stock market capitalization rate, % of GDP	I		23P4
Cost to create collateral	II		23S1
Country credit rating	II		23S2
Legal rights of borrowers and lenders index	II		23S3
Real Interest rate	I		23S4
<b>External Sector</b>			
Aid , % GNI	I		24P1
Current account balance, % GDP	I		24P2
Debt service ratio, % exports	I	MDG	24P3
Export growth of goods and services	I		24P4
Foreign direct investment, % GDP	I		24P5
Gross international reserves, months of imports	I	EcGov	24P6
Gross Private capital inflows, % GDP	I		24P7

Indicators	Level <sup>a</sup>	MDG, MCA, or EcGov <sup>b</sup>	Indicator Code
Present value of debt, % GNI	I		24P8
Remittance receipts, % exports	I		24P9
Trade, % GDP	I		24P10
Exports of services, % total exports	I		24P11
Imports of services, % total exports	I		24P12
Actual and expected trade size, index	I		24P13
Time to trade, days	I		24P14
Merchandise exports from CAFTA countries, millions of current USD	I		24P15
Merchandise imports to CAFTA countries, millions of current USD	I		24P16
Concentration of exports	II		24S1
Inward FDI Potential Index	II		24S2
Net barter terms of trade	II		24S3
Real effective exchange rate (REER)	II	EcGov	24S4
Structure of merchandise exports	II		24S5
Trade policy index	II	MCA, EcGov	24S6
Composition of merchandise exports from CAFTA countries, by country, millions of current USD	II		24S7
Composition of merchandise imports to CAFTA countries, by country, millions of current USD	II		24S8
<b>Economic Infrastructure</b>			
Internet users per 1000 people	I	MDG	25P1
Overall infrastructure quality	I	EcGov	25P2
Telephone density, fixed line and mobile	I	MDG	25P3
Quality of infrastructure – railroads, ports, air Transport, and electricity	II		25S1
Telephone cost, average local call	II		25S2
<b>Science and Technology</b>			
Expenditure for R&D, % GNI	I		26P1
FDI and technology transfer index	I		26P2
Patent applications filed by residents	I		26P3
<b>PRO-POOR GROWTH ENVIRONMENT</b>			
<b>Health</b>			
HIV prevalence	I		31P1
Life expectancy at birth	I		31P2
Maternal mortality rate	I	MDG	31P3
Access to improved sanitation	II	MDG	31S1
Access to improved water source	II	MDG	31S2
Births attended by skilled health personnel	II	MDG	31S3

Indicators	Level <sup>a</sup>	MDG, MCA, or EcGov <sup>b</sup>	Indicator Code
Child immunization rate	II		31S4
Prevalence of child malnutrition (weight for age)	II		31S5
Public health expenditure, % GDP	II	EcGov	31S6
Education			
Net primary enrollment rate	I	MDG	32P1
Persistence in school to grade 5	I	MDG	32P2
Youth literacy rate	I		32P3
Education expenditure, primary, % GDP	II	MCA, EcGov	32S1
Expenditure per student, % GDP per capita – primary, secondary, and tertiary	II	EcGov	32S2
Pupil-teacher ratio, primary school	II		32S3
Employment and Workforce			
Labor force participation rate, females, males, total	I		33P1
Rigidity of employment index	I	EcGov	33P2
Size and growth of the labor force	I		33P3
Unemployment rate	I		33P4
Agriculture			
Agriculture value added per worker	I		34P1
Cereal yield	I		34P2
Growth in agricultural value-added	I		34P3
Agricultural policy costs index	II	EcGov	34S1
Crop production index	II		34S2
Livestock production index	II		34S3

<sup>a</sup> Level I—primary performance indicators, Level II—supporting diagnostic indicators

<sup>b</sup> MDG—Millennium Development Goal indicator

MCA—Millennium Challenge Account indicator

EcGov—Major indicators of economic governance, which in USAID’s Strategic Management Interim Guidance includes “microeconomic and macroeconomic policy and institutional frameworks and operations for economic stability, efficiency, and growth.” Economic governance therefore encompasses fiscal and monetary management, trade and exchange rate policy, legal and regulatory systems affecting the business environment, infrastructure quality, and budget allocation.