

## GUATEMALA - SOCIAL INVESTMENT STRATEGY

### I. BACKGROUND

1. Growth Not Widely Shared. The medium term strategy to deal with the country's most urgent poverty problems which the Guatemalan authorities have devised with assistance from the World Bank and UNDP, should be viewed against the background of the country's long-term economic and social trends. In the 1960's and 1970's, Guatemala enjoyed relatively high economic growth, low rates of inflation, a stable currency, a comfortable balance of payments position and a low external debt. The benefits of growth were not widely distributed, however, perpetuating the striking inequalities of income and wealth which have been characteristic of this culturally and socially diverse society for over a century. Even at the end of the period of rapid growth in 1980, about two-thirds of families lived in poverty; in fact according to the 1980 Household Survey, almost 3/4 of the indigenous families in the Western highlands could not feed their members properly.

2. The Crisis of the Early 1980's. These long-term structural problems were aggravated by the economic and political crises which the country experienced in the early 1980s, reflecting the deterioration of external economic conditions, inadequate and untimely adjustments of economic policies and the civic conflict which affected rural Guatemala with special severity. By 1985 foreign trade was disrupted, inflation exceeded 30 percent, over 40 percent of the active population was underemployed, investment and savings had fallen by nearly half, per capita GDP was more than 20% below its 1980 level, the external debt had tripled and external payment arrears amounted to more than US\$600 million.

3. Stabilization and Renewed Growth. The current Government, which took office in the spring of 1986, has tackled these problems with commendable courage and determination. As a result of its stabilization and incentive policies, the GDP decline was halted in 1986 and during 1987 and 1988 output grew by 3.1% and 3.5%, respectively; the rate of inflation was reduced from over 40% to around 10%, despite the unification of the foreign exchange rate at a substantially lower level and the deregulation of most consumer prices; there has been a very significant growth in non-traditional exports, the debt profile has improved and significant progress has been made in resolving the arrears problem.

4. The Social Situation. Concurrently with these relatively successful efforts at stabilization, the Guatemalan authorities have begun to focus on the problems of social neglect and extreme poverty. While these problems were aggravated by the economic decline of 1980-85, they are long-term structural problems rooted in the acute inequality of income and wealth, the cultural diversity of the society and the excessive centralization of political power, public administration and services as

well as economic activity in Guatemala City and the areas of traditional export agriculture. There is general agreement that extreme poverty in Guatemala is concentrated in the rural areas, especially the Western Highlands, the south-eastern region and to a lesser extent, the central region. There are, of course, also pockets of extreme poverty in the slum areas of Guatemala City and the larger secondary cities. The rural areas mentioned are heavily populated, contain most of Guatemala's Indian communities and have the highest concentration of mini-farms and landless. Agricultural production is atomized with a large part of the population engaged in subsistence farming and the supply of social services (education, health, nutrition, potable water, etc.) for thousands of small communities, which are often of difficult access, is grossly inadequate and often non-existent. Some of these areas have the benefit of special soil and climatic conditions which permit the production of high value export crops such as vegetables, flowers and fruits and there is a significant potential for small-scale industrial and handicraft activities among these populations which exhibit high manual skills. The creation of new jobs and higher incomes has, however, been greatly hampered not only by the paucity of physical and social infrastructure, but by the virtual absence of credit from both private and public financial institutions, inadequate agricultural extension and difficult market access.

5. In view of the economic and social conditions in the above rural areas, it is not surprising that Guatemala's social indicators are among the worst of countries with similar per capita income in Latin America. Infant mortality rates average 65 per 1,000 nationally and reach 200 in some of the poorest municipalities. Under-nutrition in the form of severe height deficits, affects over 50% of children under three years of age, with 3/4 of indigenous preschool children suffering from chronic malnutrition. Malnutrition appears to have worsened over the last 20 years. Coverage of potable water in rural areas is as low as 25%. As a result, gastrointestinal diseases continue to be the main cause of infant mortality and child and adult morbidity. In 1986 fifty-two percent of the population over 15 years of age was illiterate and in some of the poorest rural areas in the Western highlands illiteracy exceeded 80%. Only about 60% of school age children attend school in poor rural areas and more than half of them have to repeat the first grade. The rate of repetition and desertion is such that of 100 children who entered the first grade of primary school in rural areas in 1982, only 17 completed the 6th grade by 1987.

6. Need to Invest More and More Effectively in the Social Sectors. The precarious economic and social situation of Guatemala's poor communities reflects the failure over many years to make adequate investments in the social sectors, to target and use public resources effectively and to involve the communities themselves, non-Governmental organizations (NGOs) and the private sector in the attack on poverty problems on a sustained basis. It is this failure of the nation to invest adequately in the development of its human resources, which the present, democratically elected Government has called "the social debt". In other documents, submitted by the Guatemalan authorities and the World Bank to the Consultative Group Meeting, especially the Public Sector Expenditure Review, the causes of the failure to make reasonable progress in addressing the country's social problems are analyzed in depth. The analysis can be summarized as follows: (1) Guatemala's over-all level of public

expenditures is low compared with the unmet needs of its population. Central Government expenditures are only about one-half of the level in other countries with similar per capita income and expenditures on health and education are only about one-third as large as in these countries. The low level of public spending results mainly from low resource mobilization--the country's tax burden remains one of the lowest in the world. A sustained effort to mobilize additional resources is clearly required in the form of better tax and customs administration, for which the 1987 tax reform has laid a basis, as well as more adequate and timely adjustment of public utility tariffs; (ii) if progress is to be made in paying the "social debt", there will have to be a substantial increase in the resources allocated to the social sectors. The Public Sector Expenditure Review recommends that, as a medium term goal, investment in the social sectors (education, health and nutrition, basic housing, and municipal development) as a percentage of total Government investment be increased from about 24% to at least 30% and that, as a percentage of GDP, investment in these sectors be increased by about 60%. At the same time a doubling in the current level of investment in water supply is advocated. (iii) The increase in the allocation of resources would not be justified, however, if it were not paralleled by a major improvement in the utilization and targeting of existing resources. As spelled out in subsequent sections of this report, in the case of health and nutrition, this implies increasing the share of resources allocated for primary and preventive health care and reallocating both resources and staff from Guatemala City to the rural areas. In education it implies increasing the allocation of funds for primary and pre-primary education as well as for supplies and materials while decreasing the share allocated to higher education and decentralizing resources and staff. In water supply financial reforms to ensure adequate cost recovery, elimination of the existing fragmentation of sector institutions and increased emphasis on helping local communities and on dealing with increasingly serious contamination problems is called for.

7. Limited Implementation Capacity of Line Ministries. Perhaps the greatest challenge which the Guatemalan authorities face in trying to mount a broader and more effective effort in dealing with poverty problems is the limited capacity of the key Ministries to design programs and projects and their even greater difficulty to carry them out in an effective and timely fashion. It is important to note in this context that in 1986, the Ministries of Health and Education were able to utilize only about a quarter of their budgeted investment resources and in 1988, despite efforts to improve the execution of investment projects in various sectors, it appears that there was still considerable under-execution of the capital budget. While the withholding of some counterpart funds may be an important reason for poor project execution, the major causes seem to be numerous and deep-seated. Among them are the excessive centralization of decision making, expenditure control and staffing authority; a overly legalistic, rigid and time consuming system of procurement and ex-ante auditing; antiquated and unnecessarily complex bureaucratic procedures and, perhaps most importantly, the lack of well-trained and motivated staff and its excessive concentration in Guatemala City. Other contributing causes are poor project preparation, the proliferation of often over-lapping programs and projects as a result of poor donor coordination and ad hoc budgeting.

8. Dealing with these complex problems of public administration is difficult and time consuming, but the Guatemalan authorities have started efforts to decentralize the operations of both the Health and Education Ministries and are committed to tackle some of the key bottlenecks in the way of more effective program and project design and execution. In this effort they need and deserve the coordinated support of the donor community.

9. Strength at Local Level. One of the great strengths of Guatemalan society is the vigor of its community life at the grassroots level, in the thousands of small rural settlements that dot the country side and the over 300 Municipalities which are the smallest units of the country's political and administrative organization. Historically, Guatemala has had a relatively well-developed system of municipal autonomy and finance. While the municipal system and, indeed, the entire social fabric was gravely weakened as a result of the violent civic conflict of the early 1980s, the institutions of municipal government are being reconstructed and at the "aldea" (rural village) level a proliferation of special purpose, local committees has emerged. These committees, which have a formal structure (i.e., officers and the legal right to manage funds) and are usually temporary, arise in response to specific needs such as the desire for a new school, a better access road, an improved water system etc. Together they constitute a vast, informal, decentralized, rural service delivery system. The local groups, often with the help of local promoters and technicians employed by public institutions or NGOs secure outside financing and services and then carry out the projects. Most Government and virtually all NGO programs, that try to work with the rural poor, employ this organizational model.

10. The organizational capacity of local communities, their ability to identify and define their own needs and their willingness to work hard to implement programs to meet these needs was strikingly demonstrated during the reconstruction period following the 1976 Earthquake. It is during this period that members of Guatemala's urban middle class and especially, its technical elite became fully aware of the depth of poverty in the rural areas and of the willingness and ability of the rural poor to help themselves, if provided with technical and financial assistance. It was also during these years that many foreign and some domestic non-Governmental organizations first started to operate on a significant scale in the country's interior.

11. Efforts to Decentralize and Strengthen Municipalities. By the time Guatemala's new Constitution was approved and the present, democratically elected Government took office in early 1986, there was a national consensus in favor of political and administrative decentralization and the need for more local participation in decision making. This consensus found its concrete expression in two Congressional Decree Laws of which the first (Decree 70-86) created eight development regions to promote administrative decentralization and the second (Decree 52-87) a system of urban and rural development councils at the national, regional, departmental and municipal levels. These councils, which are not yet fully operative, are designed to improve the formulation and coordination of urban and rural development policies and promote the participation of all parts of the society in the efforts at urban and rural

development on a decentralized basis. A more immediately tangible expression of the desire to decentralize has been the implementation during the last three years of Article 257 of Guatemala's 1985 Constitution which calls for the transfer to the municipalities of 8% of ordinary Government revenues. These resources are destined for investment in municipal infrastructure and public services. The transfers to the 330 Municipalities have reportedly amounted to Q 55.2 million (US\$19.4 million) in 1986, Q 105 million (US\$38.9 million) in 1987 and Q 122 million (US\$45.2 million) in 1988. The significance of this amount in strengthening the financial capacity of the municipalities becomes clear in light of the fact that last year their own revenues amounted to only Q 30.7 million (US\$11.4 million) and covered barely two-thirds of operating costs, while the 8% transfer financed over 90% of the municipalities' significantly enlarged investment budgets. In a subsequent section of this report, the positive and negative aspects of the utilization to date of the 8% resources are discussed. Suffice it to state here that, on balance the experience seems to have been positive and that the new mechanism constitutes a demand-driven funding chain which is fast-disbursing and responsive to the needs of the local communities.

12. Increased NGO Involvement. With the advent of a democratic government in 1986, some of whose members had considerable experience in designing and managing NGO development projects in the period following the 1976 earthquake, NGO's have become more numerous and active than ever. There are over 200 such organization at present operating in Guatemala, of which 54 invest in excess of \$50,000 annually. It is estimated that in 1988 these 54 spent US\$13.3 million on education and health projects, US\$5.8 million on infrastructure and US\$7.3 million on agriculture and micro-enterprise projects. Given their proven ability to work closely with cooperatives, municipal and village development committees and other forms of associative organizations, the NGOs constitute another effective demand-driven funding chain. Moreover, they often work closely with one another and with technical Government agencies on a complementary basis. At the same time various Government departments and agencies have started a number of credit programs, some of them using NGOs as technical agents, others working through cooperatives or other community associations or groups aimed at micro-enterprises and small farmers in the rural and urban poverty areas. These programs are of varying quality but some have established close contacts at the grassroots level and are effective in providing appropriate technical and financial assistance.

## II. THE PROPOSED SOCIAL INVESTMENT PROGRAM

13. The proposed Government strategy to deal with the country's most urgent poverty problems has been devised in the light of the analysis of economic and social trends which has been presented in the first part of this report. It is clear from this analysis that the poverty problems are so deep-seated and pervasive, that a comprehensive strategy is needed, involving not only the line Ministries, but also the municipalities, NGOs and the private sector. Even assuming successful Government efforts to mobilize additional resources, an increase in public sector spending on the social sectors and more effective implementation of existing programs and projects, resources will still be limited relative to what is needed to

tackle Guatemala's poverty problems. Under these circumstances only a sharply targeted, cost-effective program can be contemplated. The program articulates in some detail the approach of complementing the effort to make the economy more open and internationally competitive with a domestic development strategy in which reinforcing the local economies and improving the social services for the poorest groups of the population are explicitly recognized as deserving very high priority (as spelled out in the "Programa de Reordenamiento Económico y Social," Memorandum I and the "Programa de Reorganización Nacional," Memorandum II). The proposed Social Investment Strategy and the Social Investment Fund would make a significant contribution to the Government's domestic strategy and the consolidation of democratic institutions.

14. The major objectives and most significant features of the various components of the proposed program are presented in subsequent sections of this report. A more detailed analysis of sector policies and of on-going and proposed programs and projects is contained in the working papers prepared by the World Bank team which visited Guatemala in late January and early February 1989 and which worked closely together with teams of high level Government officials. As stressed in the preface to this report, the representatives, staff and consultants of UNDP, the IDB, USAID, other bilateral donors, as well as of NGOs, Government Ministries and decentralized institutions also played a very important role in this combined effort. It should be stressed that while a good deal of progress has been made in determining key elements and preparing the outline of a possible institutional framework to carry out the proposed program, much further work is needed to arrive at reasonably firm estimates of the funding requirements of some of its components, to refine the proposed program and project criteria and determine the legal basis and operating procedures of the proposed institutional framework.

15. Outline of the Program. The key objectives of the proposed Social Investment Program are:

- (a) to make significant progress in reducing the rates of mortality, malnutrition and illiteracy of the general population and especially of the children in the rural poverty areas which have the worst social indicators;
- (b) to expand and improve the social infrastructure (water supply, latrines, sewage, health posts, schools and rural access roads) at the municipal and village level; and
- (c) help raise the incomes and improve the employment opportunities and the social services of the rural and urban poor.

16. The program will have three components which are to be carried out and financed as follows:

- (a) The first component is designed to improve the targeting and implementation and in some cases, enlarge the scope of priority programs of the Ministries of Health and Education in the areas of primary and preventive health care, nutrition as well as primary and preprimary education. One of its important objectives is to help the Ministries in their efforts to decentralize their

operations and assist the municipalities, NGOs and community groups to play an increasingly important role in developing and operating programs to improve child and maternal health care, nutrition as well as primary and pre-primary education. This component is to be financed from budgetary and external resources through conventional channels;

- (b) the second component aims to increase the municipalities' technical and financial ability to construct, maintain and operate social infrastructure facilities, especially in the rural poverty areas by providing them with resources which supplement the 8% constitutional transfers;
- (c) the third component is designed to help the rural and urban poor to improve their incomes, employment opportunities, health, nutrition and education by financing productive and social programs and projects through NGOs, cooperatives and other forms of association, at the local level. These activities would complement the efforts of the line Ministries and municipalities.

17. An autonomous Social Investment Fund is to be created to finance the second and third components of the program. The new Fund is to be capitalized and financed from budgetary resources as well as external grants and credits.

18. Coordination, Monitoring and Evaluation of the Program. It is proposed that the Minister of Finance form a small unit in the External Financing and Trust Fund Department of the Ministry which would coordinate and monitor the progress of the entire social investment program. This unit would: (i) coordinate the flow of budget resources and of external donations and credits to the Ministries and the proposed Fund; (ii) monitor the progress of the three components of the program and prepare an annual evaluation. For this task independent consultants would be employed. The annual evaluation would be presented to the donors and the members of the Social Cabinet (the Secretary of Planning and the Ministers of Finance, Development, Health, Education and Public Works) and the Board of Directors of the Social Fund (which is discussed in para 53, below). The Social Cabinet and the Board of the Fund would propose possible adjustments of the program, based on the results of the annual evaluations. These proposals as well as the evaluation reports would be reviewed by the donors on an annual basis; (iii) maintain a data base covering all aspects of the program; and (iv) ensure that the Statistical Institute of the Planning Ministry carries out national surveys of living standards.

19. A more detailed discussion of the three components of the programs, the justification for the creation of a new Fund and a description of its proposed structure and modus operandi are presented in Part III below.

### III. PROGRAM STRATEGY BY MAIN COMPONENTS

#### THE FIRST COMPONENT

##### A. Ministry of Health

##### Policies

20. The recently elected democratic government has given highest priority to primary and preventive health care (Programa de Reorganización Nacional, Memorandum II and Políticas de Salud). This reflects an important departure from previous policies and is reflected in important changes in basic health indicators: (i) infant mortality due to immunopreventable diseases has diminished--whooping cough from 6.0 to 3.7 per 100,000 and measles from 9.1 to 2.1 per 100,000 between 1986 and 1987 -- partly as a result of recent increased immunization. Coverage of immunizations for children under one year of age for all major diseases remains, however, below 50%; (ii) fluoridation of water has been instituted and the iodine and vitamin A fortification laws have been reinstituted. As a result the serious deterioration in iodine and vitamin deficiency, which occurred in the late 1970's and early 1980's, has been halted. Constant vigilance is needed, however; (iii) Training has improved, especially of paramedical and auxiliary health personnel; and (iv) Administrative regionalization plans and strategies have been drawn up.

21. Although chronic undernutrition in children between 6 and 36 months of age has increased from 50% to 57% between 1965 and 1987, the Ministry of Health has so far remained a relatively passive participant in the nutrition area. Except for the reinstitution of food fortification regulations, nutrition programs have been externally designed and funded. They are largely restricted to untargeted maternal child health (MCH) feeding programs carried out within public health centers but managed by NGOs, the World Food Program and bilateral donors. The synergy between health and nutrition problems, which the MOH recognizes, makes it imperative to address both problems in a coherent and coordinated manner. A malnourished child is likely to have more prolonged bouts of disease and a sick child will undoubtedly lose weight. Moreover, given the scarce public health resources in Guatemala, the country cannot afford the inefficiency of vertical programs in both health and nutrition. In recent years, growth monitoring of children has been proven to be an effective mechanism for promoting improved nutrition and integrating preventive health care and nutrition.

##### Objectives

22. In the short-term (to 1991) the Ministry of Health has set the following goals: (i) to eradicate polio and reduce significantly malaria, dengue and immunopreventable diseases; (ii) to reduce infant mortality by one-half from the 1988 level; (iii) to reduce maternal mortality to 1 per 1000 through increasing coverage and training of public health staff and voluntary workers, especially midwives who attend 70% of the births in Guatemala; (iv) to increase access to potable water in rural areas through



UNEPAR and the Division of Sanitation; (v) to reduce malnutrition significantly through better management of food aid (in coordination with implementing agencies) and through better design and targeting of maternal child health and nutrition programs.

23. In nutrition, the Ministry proposes to increase the proportion of food aid which is allocated to maternal and child feeding programs and to improve targeting. Actually, only one-third of the \$27 million of food aid programmed in Guatemala is devoted to maternal and child feeding programs and even that is not targeted, based on nutritional need. The rest of program food aid is distributed through food for work and school feeding programs neither of which is targeted on nutritional need. Weight-for-age or weight-for-height measures could be used to identify those in greatest need of food assistance.

24. The Government believes that this short term strategy, which will improve health indicators considerably, ought to be complemented with more far-reaching actions over the longer term to improve health system efficiency and to coordinate and finance other institutions in order to maintain and improve health indicators. The Ministry will have to make a major effort to improve the efficiency and executive performance of its operations through: (i) institutional and financial decentralization; (ii) delegating more responsibility to the regions and to executing agencies; (iii) rationalizing staffing patterns with preventive and curative health care goals at the primary and ambulatory level; (iv) improving the operation of hospitals through better management, cost and inventory control, physical maintenance, and auditing; and (v) developing a strategy of growth monitoring as part of the primary health care strategy. Growth monitoring includes regular weighing, targeted food resource transfers and nutrition counselling. To accomplish these improvements, the Ministry of Health will require additional technical and financial assistance. All food aid donors and implementing agencies will need to coordinate their program among themselves and with the Ministry to assure that food aid supports the primary health care strategy.

#### Ongoing Donor Support

25. Tables 1, 2 and 3 (which are attached to the report) indicate that the donors have given considerable support to the Ministry of Health and provided food aid in a variety of ways. The programs include credit from the IDB for aqueducts and sewers and AID support for immunization, Child Survival and Oral Rehydration (ORT) as well as improvement of the information system and institutional development. Technical assistance and resources from WHO/PAHO, UNICEF, and the bilateral donors (Germany, France, and Italy) are also included. Total donor resources for the MOH programs, including credits for sanitation, total US\$38.5 million for 1989, US\$9.8 million for 1990, and US\$9.5 million for 1991. Food Aid in these years will average about US\$60 million.

26. Existing programs have tended to support the primary health care and sanitation strategy of the Government and have had a considerable impact on immunopreventable diseases and the improvement and expansion of the health service infrastructure. Nonetheless, there are several problems which should be resolved by the donors and the government to improve the efficiency and impact of ongoing external assistance.

27. The Major Problems to be Resolved by Donors are: (i) lack of coordination between donors and government on national priorities and the recurrent cost implications of projects; (ii) lack of integration of projects in the administrative structure of the Ministry of Health and failure to strengthen this structure instead of increasing fragmentation and conflict; (iii) inadequate integration of national teams in the formulation, execution and supervision of donor projects and programs through in-service training; (iv) inadequate institutional support for badly needed projects with high software components; and (v) slow disbursement by donor agencies.

28. The Major Problems to be Resolved by the Government are: (i) the complicated administrative structure, complex procedures, and excessive centralization in decision-making and execution of projects; (ii) lack of continuity in project management (the AID funded immunization and oral rehydration project, EPI/ORT, has had 4 directors since the beginning of 1986, for example); (iii) use of funds for activities not stipulated in the original agreements, which creates conflicts and delays (partly resulting from the narrow focus of projects which don't consider more comprehensive primary health care actions); and (iv) lack of coordination among units responsible for programs within the Ministry and between the Ministry and executing agencies.

29. The Government is now taking actions which will correct some of these problems. For example, the EPI/ORT project, funded by AID at US\$16 million, has disbursed only 25% of the resources in over half the life of project, so the Government is (i) reorganizing the administrative unit and (ii) providing training in financial management to project staff, which should accelerate the implementation of the project so it can be completed on schedule in 1991.

#### Actions to be Taken by the Ministry of Health

30. The Government has appointed working groups to prepare a strategy for an integrated health and nutrition program that would focus both on urgently needed actions to achieve the Ministry's short-term objectives and on ways to decentralize the Ministry and improve its operations. Over the next 3-6 months, these working groups will prepare a document that should contain several elements: (i) an assessment of the need to train midwives, other voluntary workers, nurses, rural health technicians and high level health workers in order to increase preventive and curative health coverage; (ii) an evaluation of the needs for staff, goods and services of the existing health centers (type B) and health posts throughout the country and a study of the possibility that the municipalities would gradually become responsible for the operation of these centers and posts; (iii) a plan to increase the capacity of the Department of Food Control (staff, equipment, laboratory, vehicles) in order to increase significantly food industry compliance with the food fortification laws; (iv) a proposal to increase resources for nutrition from the Ministry in order to support the activities of growth monitoring and nutrition screening; (v) a plan of action to achieve universal coverage of growth monitoring (weight-age) in the maternal child health program and to screen for entry and exit in food aid programs. The strategy should include the necessary personnel, supervision, training, equipment, and educational strategy and materials

for growth promotion; and (vi) an analysis of financial aid received by the health and nutrition sectors, indicating the objectives of the multiple projects in execution, their complementarity and/or substitutability and ways to better target, rationalize and consolidate these projects to meet the Government's objective of primary health care.

31. On the basis of the above analysis, the group would be in a position to estimate the additional local and external resources required to achieve both the short-term and longer-term objectives of the Government's health care and nutrition strategy. These resources might be provided through a sector operation, supported by a group of interested external financial institutions and donors (a group of AID financed consultants is already assisting the Ministry in a study of the decentralization of its operations.)

## B. Ministry of Education

### Policy

32. The Ministry of Education's strategy assigns the highest priority to the improvement of primary and pre-primary education (0-6 years) in the rural areas. Primary education is assigned high priority given its well known, high social rates of return and contribution to poverty alleviation. Pre-primary education holds the promise of greatly increasing the social rate of return of primary education by helping to reduce the very high rates of repetition and desertion of the two first grades of primary education.

### Expanding Primary Education

33. In order to carry out this strategy the Ministry intends to implement as rapidly as possible the Basic Education Project which has secured World Bank financing as soon as the loan has been approved by the Guatemalan Congress. That project (US\$60 million, of which US\$30 million is to be financed from the World Bank loan) is to assist the Government to expand the coverage of primary education from 60% at present to 80% in 1991. Other external funds which are available to finance the expansion of coverage and the improvement of primary education, as shown in table 4, include: (i) the first primary education loan from the World Bank of which US\$7.2 million are still to be disbursed and (ii) the PRODEPRIR project for basic education in rural areas, financed by the Inter-American Development Bank, of which US\$19 million are still undisbursed.

34. Some of the causes for slow project implementation of education projects are similar to those already mentioned in the case of health and nutrition, i.e. proliferation of project units, excessively complex and time-consuming bureaucratic procedures and delays in providing budgeted counterpart funds. If progress is made in correcting these shortcomings by both the Government and donors, already available funds should prove adequate to achieve the desired increase in the coverage of primary education over-all and in the rural poverty areas.

35. Expanding Pre-Primary Education. Financial assistance for pre-primary education has been quite limited up to now, even though the social rates of return may well be even higher than for primary education. This

is especially the case in Guatemala in view of the cultural and linguistic diversity of the population (the Indian communities have 23 different languages, of which four are spoken by relatively large parts of the indigenous population) and the difficulty of the Ministry of Education to provide good bilingual education. Moreover, pre-school children show the worst indicators of malnutrition and do not have access to the food assistance distributed through the school and health care systems. In order to expand pre-primary education, the Ministry is proposing to expand and improve the "Programa de Atencion Integral" (PAIN) to the rural poverty areas through a project which is being prepared. The project envisages the participation of the parents and of the communities which have to play a key role in the implementation of this type of project, since they are in the best position to gauge the need and can reduce the costs by participating in the project. Consequently, the Ministry intends as part of its strategy to support through technical advice, the preparation of manuals, curricula and textbooks the activities of the Ministry of Health, the municipalities and the NGOs and other community groups if it can be reimbursed for these services.

36. The project which the Ministry of Education is preparing, is tentatively estimated to cost US\$6.4 million. It is designed to expand the scope of the "PAIN" projects from its present coverage of only 7,300 children to 500,000 children over a 5 year period. While the project is ambitious, it is clear that there is ample scope for such a project and that major efforts will be needed to promote it and secure the participation of the communities which is indispensable if the coverage and effectiveness of primary education is to be greatly increased. The Ministry of Education has committed itself to prepare a pre-feasibility study of the project within the next three months.

#### THE SECOND AND THIRD COMPONENTS

37. Why Create a Social Investment Fund? As already noted, the second and third components of the proposed Social Investment Program are to be financed through a Social Investment Fund. The question naturally arises why the creation of such new institution is necessary. In the first part of this report, the limited administrative capacity of the line Ministries (Health and Education) has been stressed. It is estimated that the activities of the Ministry of Health reach only about 35% of the population, that only a small proportion of the nutrition programs is directed towards the neediest groups in the rural poverty areas, that primary education coverage is only 60% at the present time while pre-primary schooling reaches only 4% of children of 5 and 6 years of age - almost all of it concentrated in the urban areas. It should be stressed, moreover, that the cultural diversity, topography and settlement pattern of Guatemala's rural poverty areas are such that it is virtually impossible to carry out many of the most important social programs effectively in these areas through Central Government departments. At the same time, the 8% Constitutional transfer mechanism to the municipalities and the increased activities of NGOs and other private and public intermediary institutions have evolved into promising alternative channels to the rural communities. To take advantage of these alternative, demand-driven channels, a financial mechanism is needed which is reasonably protected against political pressures. Such an institution should be able to act fast and flexibly, on a decentralized basis. It should be able to build up a sound program of

social infrastructure and significant productive and social projects meeting the needs of poor rural and urban communities by encouraging a variety of approaches on a pilot basis. An important reason why it has been decided that the new Fund should finance both the second and third components of the proposed program, is to assure that the expressed needs of the local communities and their action committees are fully taken into account. For example, if a local community wants to secure financing for an improved local water system and is not able to secure support from either a Central Government program or through the 8% municipal program or the supplement to that program, it would still be in a position to secure financing through one of the NGOs' programs that will have access to the Fund. At the same time, having the same institution available to finance both social infrastructure and productive projects in the same municipality creates the possibility for the financing of complementary activities which are mutually reinforcing. Another attractive feature of this new, autonomous institution is that it can emerge as a major vehicle for donor financing and coordination.

38. The new Fund would be an autonomous institution. It would have a Board of no more than three persons who would be selected as private individuals and not as representatives of the Government or of public and private institutions, an Executive Director with supporting legal, financial and information staff, and two operating departments as well as 2-3 regional offices. One operating department would provide supplementary funds to the 8% Government transfer to municipalities while the other department would finance productive and social projects through NGOs and other types of associations. (The detailed institutional arrangements will be discussed in paras. 53-61 below.)

#### THE SECOND COMPONENT

39. The second component of the Social Investment Program will involve supplying the municipalities of Guatemala with funds which would supplement the 8% Constitutional transfer which, as noted in part I, has for the last 3 years enabled the municipalities to increase their investment programs significantly. A number of independent assessments carried out by AID and Ford Foundation consultants as well as Guatemala's Municipal Development Institute (INFOM) have concluded that the transfer mechanism has worked relatively well. As noted in para 11 above, over US\$45 million was transferred to the 330 municipalities in 1988, financing many thousands of small scale projects. While information is still incomplete, it appears, not surprisingly, that initially a significant proportion of the resource financed high visibility investments, mostly in the urban areas, but in the second and third year an increasing share went to fund investment in water, sewage, access roads, health posts and schools in rural areas. At the start, the majority of projects were carried out by force account of the municipalities, but it is estimated that in the third year about 60 percent of investments were carried out by private contractors, many of them operating outside Guatemala City for the first time. It is noteworthy that the funds were made available directly to the Central Bank accounts of the municipalities on a quarterly basis and that they were committed and disbursed rapidly. The economic and social impact in terms of income and short-term employment has been positive over-all and the rebuilding of local institutions and of the social fabric in the communities affected by economic decline and the civic conflict has been significant. Another important positive aspect has been the strengthening of the democratic process and increasing community participation in decision-making.

40. Among the shortcomings of the workings of the 8% transfer to date the following should be noted: (i) the investments made were often not of high priority, and did not always focus on alleviating extreme poverty in rural areas; (ii) the fact that use of funds has been limited to investment, has led to an imbalance between investment and recurrent cost expenditures. This is especially serious because the municipal revenue base is still very weak with the municipalities having to rely on limited Central Government subsidies to finance a good part of maintenance and operations; (iii) there has been a lack of incentives for the municipalities to increase their own revenues; (iv) costs have varied greatly, reflecting initially a lack of competition, high transport costs and the absence of effective cost controls; (v) lack of adequate project preparation and supervision has in some cases been a major cause of low quality and (vi) there has been virtually no audit since staff of the Comptroller General's Office visits individual municipalities very infrequently.

41. The second component has been designed with a view to take advantage of the positive features of the 8% transfer mechanism and minimize some of the negative aspects which have been noted. Access to supplemental financing, to be made available on a grant basis to the municipalities by the Social Investment Fund, would call for each municipality to sign a participation agreement with the Fund. In this agreement they would commit themselves to: (i) allocate a major part of the resources to the rural areas and the rest to investments in urban low income areas; (ii) to improve the generation and collection of their own revenues, especially property taxes as well as cost recovery in the form of increased charges and tariffs for public services; (iii) to conform with the Fund's policies and technical, economic, financial and environmental criteria; (iv) to finance a part of the proposed program from their own resources, the 8% funds or through the provision of labor or materials by the local community; (v) agree to technical assistance and training considered by the technical agents of the Fund (INFOM or other qualified institutions of firms) to be indispensable for effective program execution; and (vi) agree to a permanent, independent external audit.

42. The distribution of the supplementary resources would basically follow the same criteria and procedures as the 8% Constitutional Transfer, which, on balance, favors the poorer municipalities. The funds would be made available for relatively small projects in the following areas: (i) the construction, rehabilitation and improvement of water and sewage systems and latrines; (ii) construction and repair of health centers, primary and pre-primary schools, including the financing of operating costs for existing and new health and education facilities on a decreasing scale and for a limited time to be agreed upon; (iii) upgrading and maintenance of existing rural access roads, repair of small bridges and acquisition of simple maintenance components; (iv) preinvestment studies and the supervision of construction and (v) training and technical assistance. This definition of project eligibility might well be modified in the light of experience.

43. The Social Investment Fund would have to make funds available to its technical agents--INFOM or other qualified institutions--which will ensure that the municipalities are in compliance with the criteria and procedures agreed upon.

44. By requiring that the municipalities contribute to the financing of the projects for which they seek support from the Social Investment Fund, the targeting of the 8% transfer funds to priority sectors, especially in the rural areas, is likely to be improved. At the same time, the massive training of the mayors, members of the municipal corporations and of municipal key staff should enable the municipalities to make much better use of all their resources, including the 8% transfer funds.

45. The preparation and effective execution of the second and third components of the program will be significantly assisted through a sector study of the urban and rural areas of the municipalities, the terms of reference of which have been jointly drafted by IDB and the World Bank and which should be approved in the final form by the Government in the near future.

### THE THIRD COMPONENT

46. To implement the third component of the program, the Social Investment Fund will finance productive and social projects through intermediaries (NGOs, cooperatives, or other new types of associations of small producers whose legal form is currently under study by the Government) who will present programs which may include: (i) credit for productive operations by small entrepreneurs or farmers (e.g. handicraft makers, tailors, mechanics or small farming projects like mini-irrigation); (ii) technical assistance to final beneficiaries; (iii) in some cases, the Fund would also consider financing individual productive projects of a larger size, for example a cooperative investing in a fruit collection and packing center; or (iv) projects in health, nutrition, education and social infrastructure. The fund will take as much advantage as possible of existing programs of the Government (Annex A) to finance operations of NGOs or other types of associations participating in these programs as long as these intermediaries and the projects presented by them conform to the Fund's operating criteria.

47. For small productive projects, financed through revolving funds managed by an intermediary, credit would be provided to final beneficiaries, at least at market rates, as is the practice of the 10-15 most serious NGOs in Guatemala at the present time. The projects presented would have a size limit, they should be sustainable, and should have adequate economic and financial rates of return. Because of the high cost of lending to the poor, these revolving funds require high spreads to operate. At an initial stage, they will need outright grants or quasi-grants (currently provided by IDB, USAID, and other bilateral and private donors) for their capitalization. Efficient NGOs usually take 2-3 years to expand their market coverage and volume of operations sufficiently to be able to receive funding at 8-9% p.a.

48. To qualify for financing, intermediaries will need to demonstrate institutional capacity, financial strength, experience of at least one year in their field of specialty and agreement to be audited by independent external auditors. Even the best NGOs or other associations selected will require significant technical assistance in management organization and accounting. In general, they have not yet fully bridged the gap between

their original social mission and their present broader approach which gives greater emphasis to the financing of productive projects. For this purpose, their accounting needs to be improved to assure full transparency and reveal the difference between what are in fact the operating costs of revolving funds and other elements of social assistance to beneficiaries so that it may be clearly determined which part of their program should be financed through loans and grants, respectively. Technical assistance for institutional strengthening of intermediaries would be provided by the Fund in the form of grants.

49. Technical assistance to final beneficiaries can vary considerably depending upon the type of project financed and the degree of expertise of intermediaries, and the needs of the beneficiaries. Some NGOs provide more technical and specialized advice. For example, one NGO currently promotes the use of drip irrigation for the production of non-traditional export crops and helps farmers implement these systems. Another has introduced improved breeds of sheep in the Western Highlands. A third one introduces and trains local communities to use gravity-fed potable water systems. Other NGOs provide management training to other NGOs or local groups, focussing on budgeting, planning, accounting, or the creation and operation of revolving funds for credit. Finally, several NGOs undertake the important task of training teachers and community leaders.

50. An example of a larger project would be the financing of producers of non-traditional exports such as melon, strawberries, broccoli, okra, or cut flowers. Financing could be provided to farmers through a cooperative that would provide technical assistance, credit to individual producers, and undertake the marketing of its members' products. The cooperative could also invest in a refrigerated warehouse, allowing it to export both fresh and frozen fruits and vegetables. The most successful venture in this field remains the cooperative Cuatro Pinos. This kind of success can be replicated, although it will probably require strong technical assistance. Exporters are already associated through the "Gremial de Exportadores de Productos No-Tradicionales" which is likely to be an active source of project ideas and proposals.

51. In the case of social projects in health, nutrition and education, outright grants would be provided, although the project cost would be shared by intermediaries and beneficiaries, and there would be a cost recovery element (such as charging a small amount for medicine). Examples of projects financed would be the construction and running of orphanages, population control programs, projects to improve child nutrition, provide vaccination, improve water and sanitation or the construction of classrooms, and the equipment of vocational and primary schools. To get projects started, current expenditures such as staff, medicine or books would be provided for an initial period, after which local communities would agree to finance operating costs out of their own resources so that the projects remain sustainable.

52. During the initial phase of 2-3 years, the Fund's strategy would be to select a group of 10-15 capable and experienced intermediaries which may include those already participating in existing Government programs such as IFDI, SIMME and USPADA as long as these intermediaries and the projects presented by them conform to the Fund's operating criteria and help them strengthen themselves so that they can use their existing



knowledge of local communities and replicate and expand their successful programs. This is already being done to a certain extent by NGOs and local groups themselves, supported by several Government programs (Annex A) and a number of multilateral and bilateral donors. The Fund's role will be to coordinate these efforts, unify criteria, simplify procedures, decentralize decision-making, and help disburse funds more efficiently. In the light of annual evaluations and the periodic major assessments of the program, which are envisaged, operations may be significantly expanded and modified to the extent necessary.

#### IV. THE SOCIAL INVESTMENT FUND

##### Outline of Major Features

53. As already noted the proposed Social Investment Fund is to be an autonomous institution, independent of the Government, with its precise legal status yet to be defined. It would have a Board of Directors of no more than three persons, to be nominated by the President of the Republic. These three directors, one of whom would be the Chairman of the Board, would serve as private persons, chosen on the basis of characteristics and criteria previously agreed upon. They will not represent either the Government or any public or private institution. Their terms will be staggered. They will approve operating and financial policies, criteria and procedures.

54. The Board would name the General Manager who should have management experience, be financially independent and highly respected. He will be responsible for the operations and management of the Fund. The General Manager will have the support of an administrative secretary, a financial administration unit, a legal adviser and an information unit with a data bank.

55. The Fund will have two operating departments, headed by Assistant Managers, appointed by the General Manager. One department would finance social infrastructure programs and projects, proposed by municipalities, by providing resources which supplement the 8% Constitutional revenue sharing funds. The other department would finance programs of productive and social investments undertaken by NGOs, cooperatives and other associations working at the local level. Both departments would start operations with a small technical staff, some of whom would work in the 2-3 regional offices, which the Fund should open within a few months of its start of operations. From the beginning it should adopt procedures which permit it to operate on a decentralized basis with grants and loans for relatively small and simple projects to be approved at the local level. In choosing technical agents to assess the feasibility of projects and supervise their execution, the Fund should give preference to existing institutions which operate on a decentralized basis.

56. The Fund will appraise, finance and supervise programs and projects, but will not execute them. Its operating criteria are to be prepared by an ad-hoc team in consultation with the appropriate Ministries and with the assistance of multilateral and bilateral donors and financial institutions. The criteria will be approved by the Board of Directors and should be modified if necessary in the light of experience and the independent annual evaluations.

57. The Fund's activities would focus primarily on the rural poverty areas. One of the Fund's most important tasks will be to support social, productive and infrastructure programs and projects which reflect the expressed needs of the local communities, strengthen their economies, and are complementary. The Fund should encourage local participation and contributions by the beneficiaries in the form of labor, materials or money. In this context the Fund should encourage and support the gradual incorporation of the Municipal Development Councils in the decision-making process.

58. The Fund's life will depend on the success of its operations and its ability to obtain funds from external donors; it is presumed that after some years the need for the Fund to supplement the 8% revenue sharing transfers may decline since the central government will have to supply the municipalities with greater resources or cede to them a major revenue source since they will have to assume gradually some of the responsibilities such as the operations of health facilities, schools etc. now handled on a centralized basis. Moreover, the municipalities should be in a position to collect more revenues as the local economies are strengthened.

59. In order to safeguard the autonomy of the Fund, it may be advisable to set a low limit on the extent to which the Fund's operating expenses can be financed from the national budget during any single year. Any additional cost will have to be financed by the external donors.

60. While the Fund will have to have internal audits, all its operations will have to be subject to frequent external audits to verify that they are being carried out in accordance with the agreed upon technical and financial criteria and that acceptable procurement and accounting procedures are being used. The external auditors will be contracted by the Board of Directors.

61. An outline of the suggested operating procedures of the Fund's two operating departments is presented in Annex B.

#### Next Steps Required to Establish the Proposed Social Investment Fund

62. In order to establish the proposed Social Investment Fund in the near future, the Government of Guatemala will have to form a high-level working group to determine what legal steps are needed to set up the Fund. This group should recommend the most appropriate legal framework to ensure the Fund's autonomy. It will have to decide whether the creation of the Fund requires Congressional approval of a special law or whether it might be possible to create it through a Presidential Decree, as in the case of the Bolivian Social Emergency Fund. In case Congressional approval is required, the working group will have to determine what the needed steps would be and make a realistic assessment of the time required to secure such approval; it would draft the necessary legislative proposal and the Government will have to do all it can to secure early approval of the needed legislation in an acceptable form.

63. While the legal steps to create the Fund are being taken, draft operational manuals should be prepared by a working group, comprising of high level Government officials and representatives of municipalities, NGOs and other private sector institutions based on the criteria and experience of the Bolivian Fund and of the principal financial institutions and donors operating in Guatemala.

64. To take the legal steps needed to set up the Fund and draft the operational manuals will take some time. The Government may want to give serious consideration to the possibility of using the Q 10 million (US\$3.7 million) provided in the 1989 budget for the Fund, to carry out a pilot program during this period. One possibility would be to use the funds to supplement the 8% transfer to the municipalities along the lines contemplated, another to support the programs of several important NGOs.

#### V. ESTIMATE OF INITIAL FUNDING REQUIRED BY THE PROPOSED SOCIAL INVESTMENT FUND

65. Based on the record of the municipalities in utilizing the 8% Constitutional revenue sharing funds during the last 3 years and an assessment of their ability to use additional resources effectively if they are provided with training and technical assistance, the most recent World Bank Mission has conservatively estimated that the Fund could commit and disburse about US\$90 million during its first three years of operations in supplementing the 8% resources. Commitments would total US\$15 million in the first, US\$25 million in the second and US\$50 million in the third year of operations.

66. As noted in a previous section of the report (para 52), the Mission recommends that the Fund build up its operations with the NGOs, cooperatives and other community groups prudently during its first 3 years of operations. It estimates that the Fund will be able to commit about US\$30 million in such operations during the initial three years: about US\$5 million during the first, US\$10 million during the second and US\$15 million during the third year.

67. On the basis of these tentative estimates, it appears that the proposed Fund should be able to commit at least about US\$20 million during the first year, US\$35 million during the second year, and US\$65 million during the third year, totalling about US\$120 million during its first three years of operation, of which it is suggested that the Guatemalan Government provide the equivalent of US\$20 million and the donor community about US\$100 million.