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# Presentation of the Investment Policy Review of Guatemala

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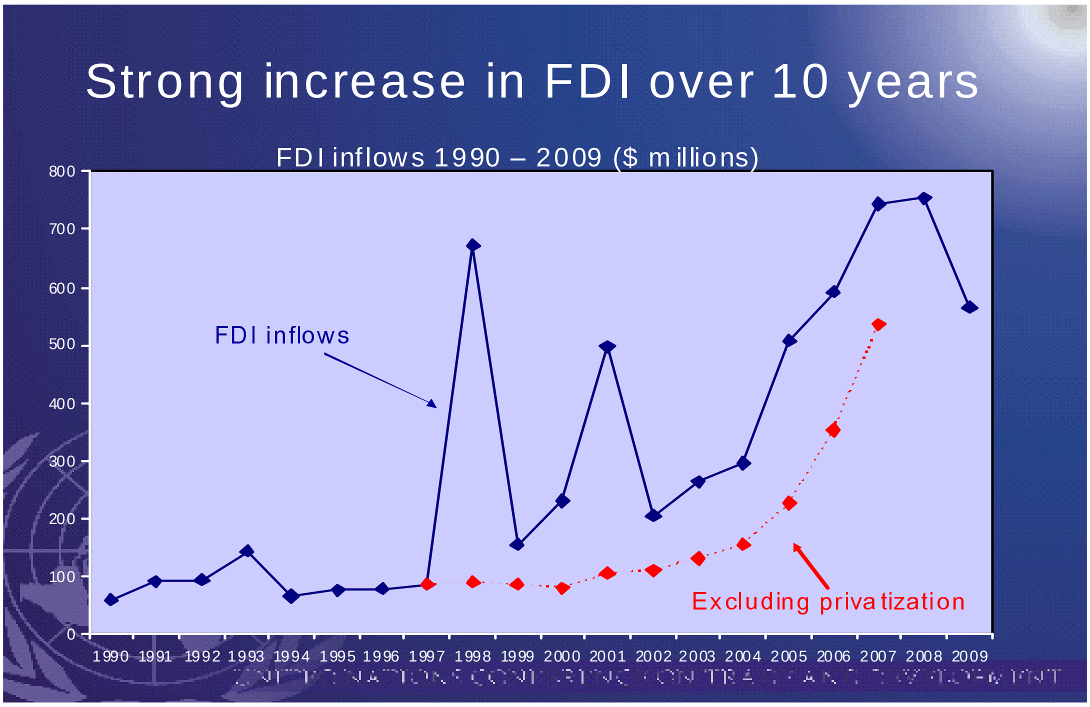
The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.

Minister Pókus Yaquián,
Vice-Minister Crúz,
Dr. Supachai,
Excellencies,
Representatives of the private sector,
Ladies and Gentlemen

My presentation of the Investment Policy Review of Guatemala will focus upon three key issues: (1) past trends in FDI and their development impact; (2) UNCTAD's key recommendations on the regulatory framework for investment; and (3) the opportunities and challenges for FDI attraction in three priority sectors, together with our main recommendations concerning these sectors.

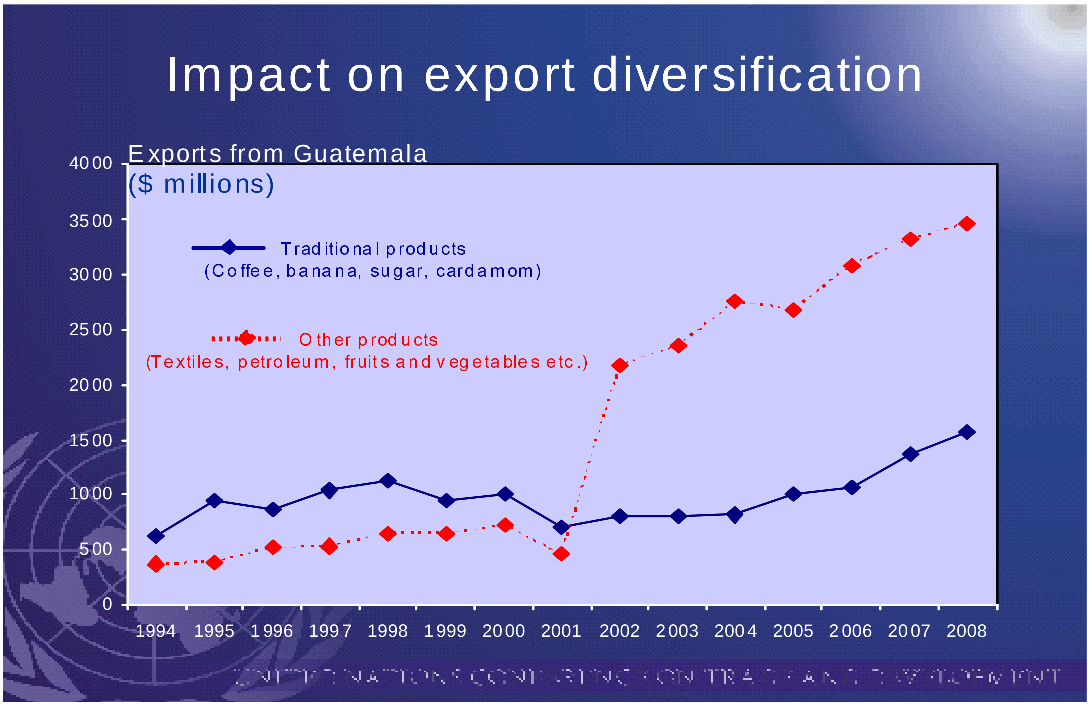



As you can observe, FDI inflows to Guatemala have risen dramatically since the late 1990s. The chart shows a steady increase in FDI, even when the peaks related to the privatization process are excluded. The key factors underpinning this positive trend are:

- The Peace Agreements of 1996 and the ensuing political and macro-economic stability;
- The privatization process, including in electricity and telecommunications;
- The Investment Law of 1998 and the establishment of the Investment Promotion Agency;
- The foreign exchange liberalization of 2001; and
- The process of trade opening, including the CAFTA-DR and bilateral trade agreements.

Guatemala has a very long FDI history, which undoubtedly contributed to shaping its economic history. More recently, FDI has impacted Guatemala's development in a number of ways, including through:

- Increased formal employment and wages in agriculture, services and manufacturing;
- Diversification of the economy, with a strong FDI presence in agriculture (traditionally concentrated in banana production, but more recently in non-traditional products, including ornamental plants or cash grain), industry (e.g. food and beverages, textiles and metals) and services (such as telecommunications, banks, electricity, commerce and call centres);
- Capital formation, though less than in other countries in the region. FDI represents around 10 % of GFCF in Guatemala against a CAFTA average of 21 %;
- Infrastructure and coverage expansion in telecommunications and energy, though the impact on prices has been mixed;
- Limited transfer of skills and linkages between TNCs and local companies.




Recent FDI inflows have also had a noticeable impact on the diversification of Guatemalan exports away from traditional products (bananas, coffee, sugar and cardamom) into new products, including garments and apparel, petroleum, fruits and vegetables, manufactured food products and minerals, all sectors which have benefited from FDI. As shown in the chart, exports from these "non-traditional" industries surpassed the export value of traditional goods in 2002. The greatest success story is the textile industry, with a large presence of foreign investors, as garments and apparel have become Guatemala's top export since 2002.

Notwithstanding the sharp increase in FDI inflows since the mid-1990s and the fact that Guatemala is the most populated country in Central America, the country significantly underperforms its neighbours in FDI attraction. It has the lowest FDI inflows per capita in the region, averaging approximately $50 per person, less than half the CAFTA average. The same is true of FDI per $1000 of GDP and of FDI as a percentage of gross fixed capital formation (GFCF), which are below all regional comparators.

As mentioned by Dr. Supachai, holding investment back are the significant challenges that persist on the social and economic fronts. Income inequality, high poverty and violence are major social problems and hamper economic growth.

We believe that Guatemala has neither explored nor capitalized as it could on its large FDI attraction potential. Indeed, the country offers investors a number of advantages, including its geographical location, which makes it a natural corridor between North and South America, the large size of its internal market, competitive labour costs and excellent telecommunications infrastructure. Guatemala could legitimately aspire to become a manufacturing and services hub for Central America.

It should also set new objectives with respect to the contribution that FDI can bring to the local economy and extract more developmental gains from FDI, including in terms of: (1) injecting competition into the domestic industry and services; (2) increasing revenue generation and employment; and (3) improving the cost and quality of key infrastructure services.

The IPR contains detailed recommendations that should help Guatemala achieve these FDI objectives. I will briefly discuss the key recommendations, while referring you to the report for more details.

Our recommendations are centered around two themes: (1) improving the regulatory and institutional framework for investment; and (2) attracting and benefiting from FDI in the sectors identified as priority by the Government, i.e. electricity, mining and infrastructure.

With respect to the first theme, the reforms adopted since the mid-1990s have introduced modern legislation and policies, which complemented an already liberal investment regime. Gaps do remain, however, in the regulatory and institutional arrangements necessary to ensure an appropriate oversight of the market. Moreover, institutional weaknesses put the delivery of important public services at risk, and compromise the protection of public interest by key regulatory agencies. In this regard, the IPR recommends a number of policy measures aimed at:

- ✓ Reforming the fiscal regime to increase government revenue and its spending capacity as well as to ensure the compliance of incentives schemes with WTO rules;
- ✓ Introducing dispute prevention and resolution mechanisms;
- ✓ Creating specialized commercial tribunals and land courts;
- ✓ Strengthening environmental monitoring and assessment;
- ✓ Improving coordination in the enforcement of intellectual property rights; and
- ✓ Adopting an improved methodology for FDI statistics collection.

In recent years, innovative IT solutions have been adopted to reduce red tape, lower operational costs and improve the interface between the public administration and the final users, notably in the areas of tax payments, customs and property registration. Such modernization should be extended to other areas of public administration, where heavy bureaucratic processes are still in place, the intermediation of notaries is too often required and duplications in forms and fees persist. This applies to construction permits, VAT reimbursement, phyto-sanitary certifications, company registration and entry of foreign labour. The report contains a number of detailed recommendations for each of these areas.

Guatemala faces important issues in terms of competition practices and regulations. Unfair business practices in many sectors generate negative consequences for consumers, represent an obstacle to company development, undermine the effectiveness of liberalization measures and encourage inefficiencies and market distortions. Adopting a competition law and policy, overseen by an autonomous agency should therefore be a priority of the development agenda. The IPR also calls for sector-specific pro-competition measures.

Guatemala has a large pool of unskilled workers concentrated in rural areas, where labour-intensive production methods prevail in agriculture and construction. In urban areas, higher education levels have allowed the development of the tertiary sector in areas such as call centers and financial services. The relevant skills are nonetheless becoming scarce. For instance, the availability of English speakers risks becoming an obstacle to new investment in those sectors. These problems are exacerbated by the relatively restrictive and highly bureaucratic legal framework applicable to the entry of expatriates, which further discourages the attraction and retention of skills to the Guatemalan economy. In this regard, the IPR recommends increasing public spending on education and introducing a proactive skills attraction programme, where FDI could play a key role.

Let me turn to the analysis of the priority sectors for FDI attraction, as selected by the Government. Guatemala has put in place a modern regulatory framework for electricity, in line with international standards for liberalized markets. This has resulted in large FDI inflows in generation, transmission and distribution.

The IPR indicates that the Government objectives for the development of the electricity sector are in line with the country's future electricity needs. Nevertheless, a number of issues threaten the sector's performance and the achievement of the objectives. Key among them are the absence of a comprehensive and integrated energy policy; inadequate "green energy" mechanisms; high prices for non-regulated users; weak enforcement mechanisms and controversies with local communities. In this respect, we recommend the Government to:

- ✓ Strengthen sectoral institutions to enable them to define, develop and communicate an integrated energy policy;
- ✓ Review the generous subsidies that distort prices;
- ✓ Adopt environmental standards, "green incentives" and a smart grid to rebalance the energy matrix;
- ✓ Consolidate the independence of the regulator and transform INDE into a public corporation.

As far as roads are concerned, Guatemala made initial steps towards launching a road concession programme that could attract FDI to projects with good socio-economic outcomes. The new public-private partnerships law establishes a sound institutional and policy framework for concessions in all sectors, including roads. In addition, Guatemala has started putting in place a coherent multimodal transport plan and identifying suitable investment projects.

These steps are in the right direction but progress is slow. It will take at least three years of hard work before FDI can be attracted on good terms for beneficial projects. The following issues should be addressed if roads concessioning is to succeed:

- ✓ The law should be complemented by a pipeline of suitable concession projects. Currently, only a wish-list is in place;
- ✓ Inspection mechanisms should be brought in line with international standards;
- ✓ A register of approved local suppliers should be established for each tender offer to reduce the risks of anti-competitive outcomes in materials' supply;
- ✓ The Ministry of Telecommunications and Infrastructure needs capacity-building in project evaluation and selection;
- ✓ The new concession agency, ANADIE, should be empowered to revise the terms of all key concessions projects; and finally,
- ✓ Political champions should be assigned to facilitating project execution by cutting red tape.

Guatemala is known to have high mineral potential in gold and nickel. Mining policy, however, has been a failure in both design and execution. This policy has resulted in low levels of FDI; poor government revenue generation; contentious relationship with indigenous communities; risks for the environment and negative effects on the country's international image.

For years, the Government and Congress have been discussing the introduction of a new mining policy. We recommend the Government to:

- ✓ Require that the attribution of mining licences be subject to the presentation and approval of appropriate mine development plans. These plans should cover technical aspects, health and safety, employment and skills development, community and local business development, mine reclamation/rehabilitation, and environmental protection.
- ✓ Introduce legal provisions granting the right to export, the right to retain sale proceeds in foreign currency and the right to convert an exploration licence to a mining licence upon approval of the mine development plan.
- ✓ Increase royalty rates and reform corporate taxation to improve government revenue.
- ✓ Create positions of mining wardens within the Ministry of Mines and Energy, tasked to handle liaison between mining companies, local communities and government agencies and devote a guaranteed share of royalties to boosting the staff and capabilities of MEM and MARN to oversee the industry.

In concluding, I would like to thank the Government of Guatemala for all the support it offered to our team during the preparation of this report. The fact that it officially endorsed the main recommendations of the IPR and that it requested technical assistance from UNCTAD for the implementation phase is an indication of the Government's commitment to improving the investment climate and we hope that the donor community will support these efforts.

Muchas gracias!